Supreme Court, U.S.
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No. 04-398 SEP 15 2004

OFFICE OF

In The
Supreme Court of the United States

MARK GLUKOWSKY,

Petitioner,

v.

EQUITY ONE, INC., a Delaware corporation,

Respondent.

VICTOR and ELAINE YURITCH,

Petitioners,

v.

COUNTRYWIDE HOME LOANS, INC., d/b/a America's Wholesale Lender, a foreign corporation,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of New Jersey

PETITION FOR A WRIT OF CERTIORARI

LEWIS G. ADLER
Counsel of Record
ROGER C. MATTSON
26 Newton Avenue
Woodbury, NJ 08096
(856) 845-1968
Fax: (856) 848-9504

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Whether Congress vested regulatory power in the states concerning prepayment penalties and other interest charges in "federally related mortgages" under their opt-out provisions of Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) 12 U.S.C. §1735(f)-7(a)?

2. Whether the Office of Thrift Supervision (OTS) regulations adopted in 1996 under the Alternative Mortgage Transaction Parity Act, 12 U.S.C. §§3801 et seq. (AMPTA or Parity Act) were ultra vires?

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OPINION BELOW

The New Jersey Supreme court opinion is reported as *Glukowsky v. Equity One, Inc.*, 180 N.J. 49 (2004). (Appendix at 1). The decision of the New Jersey Appellate Division is reported as 360 N.J. Super 1 (App. Div. 2003). (Appendix at 29). The related case of *Yuritch v. Countrywide* was decided by the New Jersey Supreme Court on the same basis in its decision reported as ___ N.J. ___ (2004), 854 A.2d 917 (2004) (Appendix at 28) without further decision.

JURISDICTION

The New Jersey Supreme Court entered its initial decision on May 26, 2004 (Appendix at 1) and entered an order denying reconsideration on June 15, 2004 (Appendix at 82). The related case of *Yuritch v. Countrywide* was decided by the New Jersey Supreme Court on the same basis in its decision reported as July 8, 2004. (Appendix at 28) This court has jurisdiction under 28 U.S.C. §1257(a) to review the N.J. Supreme Court's decision on a writ of certiorari.

STATUTORY PROVISION INVOLVED

12 U.S.C. §1735(f)-7(a)

(4) At any time after March 31, 1980, any State may adopt a provision of law placing limitations on discount points or such other charges on any loan, mortgage, credit sale, or advance described in subsection (a)(1) of this section.

STATEMENT OF FACTS

Mark Glukowsky v. Equity One

The petitioner, Mark Glukowsky, purchased a home on October 29, 1999. He obtained a loan from Equity One in order to finance the purchase. The loan included a prepayment rider, that if the mortgage loan was paid in full within the first three years of the loan the borrower would have to pay an additional charge of 3% of the amount prepaid if paid in the first year, 2% of the amount prepaid in the second year and 1% of the amount prepaid if paid in the third year.

On April 19, 2001, Mr. Glukowsky sold the property and paid off, in full, the loan with Equity One. The pay off included a prepayment penalty of $1,427.97.

Equity One, Inc. is a Delaware Corporation and a non-depository lender. The courts below have characterized the loan from Equity One to Mr. Glukowsky as a balloon mortgage subject to regulations under AMPTA and OTS regulations adopted thereunder.

Under New Jersey law, a lender such as Equity One is prohibited from charging a prepayment penalty on any loan secured by a residential property.

Yuritch v. Countrywide

Victor and Elaine Yuritch entered into a residential mortgage transaction with Countrywide Home Loans, Inc, a California Corporation, on February 2, 1999. The loan contained a variable interest rate. Victor and Elaine Yuritch sold the property and paid off the loan on November 11, 2002. Countrywide in its pay-off statement included a requirement for the payment of $6,015.10 as a

prepayment penalty calculated as six months advance interest on the amount which prepayment is in excess of twenty percent of the principle balance. The pre-payment penalty as demanded was paid at settlement on November 30, 2002 by the plaintiffs.

PROCEDURAL HISTORY

Mark Glukowsky v. Equity One

On May 17, 2001, Mr. Glukowsky filed a putative class action complaint which alleged that Equity One violated New Jersey law by charging and collecting a prepayment penalty. Count One alleged that Equity One violated N.J.S.A. 46:10B-2 by charging and collecting a prepayment penalty upon the satisfaction of the mortgage. Count Two alleged the same as regards to N.J.S.A. 17:3B-22. Count Three alleged that Equity One's actions amounted to consumer fraud in violation of N.J.S.A. 56:8-2, New Jersey Consumer Fraud Act.

In lieu of filing an answer, Equity One filed a motion to dismiss for failure to state a claim upon which relief may be granted. Mr. Glukowsky filed a cross motion for summary judgment on the legal issues raised. The trial court granted Equity One's motion holding that 12 C.F.R. §560.220 barred enforcement of N.J.'s Prepayment Penalty Law.

The case then proceeded to the New Jersey Appellate Division of the Superior Court. The court held unanimously that the OTS exceeded the scope of its authority under the Parity Act when it applied 12 C.F.R. §560.34 to state lending institutions engaged in AMTS. The panel concluded that Congress did not intend the Parity Act to

pre-empt State Consumer Protection laws that prohibited the imposition of prepayment fees on real estate transactions in general, and on alternative mortgage transactions (AMTS) in particular. The panel reinstated the claims that alleged violations of the New Jersey Prepayment Law and Consumer fraud Act.

In a 4-3 decision the New Jersey Supreme Court majority reversed the Appellate Court decision holding that the New Jersey Prepayment Law was pre-empted by the 1996 version of 12 C.F.R. §560.220. In a strongly worded dissent, citing the Appellate Court's decision, the court noted:

> *"I write further only to underscore the point that affording lenders protection under the 1996 regulation, which by now has been universally recognized as misguided, becomes especially unjust when viewed in conjunction with the sequence of events relating to the "opt-out" mechanism provided by Congress when it enacted the underlying legislation.*
>
> *In passing the Parity Act, Congress afforded each State 3 years to assert its right not to be preempted by the federal regulatory scheme.*
>
> *12 U.S.C.A.* 3804. *Congress enacted the law including that provision in 1982, some fourteen years before the suspect 1996 regulation was promulgated. During the three year window from 1982 to 1985, neither the New Jersey legislature nor that of any other State could predict that the OTS, or any other regulatory agency, someday would turn the salutary congressional goal of ensuring the availability of alternative mortgages on its head by sanctioning what arguably amounts to predatory lending practices by*

> *state chartered institutions. As explained by Judge King, the countenance of those practices, by the federal regulations' own admission, finds no support in the intent manifested by Congress when it enacted the Parity Act. That such ultra vires regulation came into being only after the states were no longer free to exempt themselves, compounds the injustice of allowing such lending practices the safe haven accorded by pre-emption in these circumstances."*

Id. at 73.

Mr. Glukowsky petitioned the court to reconsider its decision in that Congress through the adoption of the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. §1735f-7A(b)(4) (DIDMCA) specifically left the regulation of prepayment penalties, attorney's fees, late charges and similar limitations designed to protect borrowers on first residential home mortgages to the states if they chose to opt out of the federal scheme. The motion for reconsideration was denied on June 15, 2004.

Yuritch v. Countrywide

A similar complaint was filed against Countrywide as was filed against Equity One. Countrywide filed a motion to dismiss for failing to state a claim alleging the same defenses as Equity One. The trial court granted the motion to dismiss. Yuritch filed his appeal which was granted and the Appellate Division reversed the trial court for the same reasons as it did in *Glukowsky.* The New Jersey Supreme Court, relying on its decision in *Glukowsky,*

reversed the Appellate Court and reinstated the dismissal in its decision of July 8, 2004. (App. 28)

REASONS FOR GRANTING THE PETITION

I. This court should resolve the conflict between Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) 12 U.S.C. §1735(f)-7(a) and the Alternative Mortgage Transaction Parity Act (AMPTA or Parity Act) as to whether State laws adopted pursuant to the limited opt-out of DIDMCA are pre-empted by AMPTA and its regulations.

The issue concerning the conflict between the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) 12 U.S.C. §1735(f)-7(a) and the Alternative Mortgage Transaction Parity Act (AMPTA or Parity Act) 12 U.S.C. §§3801 et seq. as to whether State laws adopted pursuant to the limited opt-out of DIDMCA are pre-empted by AMPTA and its regulations, is one of first impression. There appear to be no reported decisions which address this conflict.

The issues before the court can be narrowed to a very simple analysis. The central issue concerns the interplay between AMPTA and DIDMCA. AMPTA provided for lenders to make alternative mortgages as defined by the Act. DIDMCA, specifically provides for State consumer legislation regulating first mortgage loan interest and interest related charges. The court must determine if the general grants of authority under the Parity Act somehow trump the specific reservations of authority to the States in DIDMCA. This determination is critical where a loan is covered under both acts as in the instant case.

DIDMCA applies to the instant loan. The act sets forth the requirements for loans to be covered as follows:

(a) The loan must be a first lien on residential property;

(b) The loan must have been made after March 1, 1980; and

(c) The loan must be made by a qualified lender under the act. (*see* 12 U.S.C. §1735f-7a(1))

In the instant case each of these criteria are met. The loan was a first lien on Mr. Glukowsky's residence and was made on October 29, 1999. Finally, Equity One is a lender as defined by the Act. The same is true of Mr. Yurtich's loan.

For a loan to be subject to AMPTA it must meet the following criteria:

(a) The loan must be an alternative mortgage transaction;

(b) The loan must be made by a qualified housing creditor; and

(c) The housing creditor must hold a valid state license to lend.

In Mr. Glukowsky's case, the courts below have held that the balloon mortgage was an alternative mortgage. Equity One is a qualified housing creditor as it made more than five real estate secured loans in the preceding year. Equity One is a licensed lender by the State of New Jersey.

In the Mr. Yuritch's case, the courts below have held that the variable rate mortgage was an alternative mortgage. Countrywide is a qualified housing creditor as it made more than five real estate secured loans in the

preceding year. Countrywide is a licensed lender by the State of New Jersey.

The loans in the instant case are clearly covered by both acts. The regulations under each act are clearly in conflict. The AMPTA regulation 12 C.F.R. §560.220 with 12 C.F.R. §560.34 provides that a lender **may** charge a prepayment penalty. Under the opt-out provision of DIDMCA Congress vested with the States the regulation of interest and interest charges.

DIDMCA 12 U.S.C. §1735f-7a(b)(4) provides that:

> *"Any time after March 1, 1980, any State may adopt a provision of law placing limitations on discount points or such other charges on any loan, mortgage, credit sale or advance described in subsection (a)(1) of this section."*

12 U.S.C. §1735f-7a(a)(1) provides a description of those charges.

> *"The provision of the constitution or laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged taken, received or reserved."*

It is clear from the plain language of the statute that Congress vested in the States the ability to regulate all aspects of first mortgage loan charges including prepayment penalties as long as the State adopted such a law after March 1, 1980. This is important to note as the laws and regulations relied on by both Mr. Glukowsky and Mr. Yuritch were adopted after March 1, 1980. Those laws are N.J.S.A. 17:11C-23, N.J.S.A. 17:3B-23 and N.J.A.C. 3:15-10.1(b). All of these laws

restrict the ability of lenders in New Jersey to charge a prepayment penalty.

N.J.A.C. 3:15-10.1(b) applies specifically to the lenders in the instant action and specifically prohibits prepayment penalties for all mortgages in New Jersey.

> *"A borrower may repay a first mortgage loan, second mortgage loan or consumer loan at any time without penalty."*

The New Jersey Supreme Court has incorrectly stated that DIDMCA and the Parity Act are unrelated laws. The two laws must be read in harmony both in their respective scope and purpose. There is no dispute below that New Jersey was authorized by the limited opt out provisions of DIDMCA to enact laws restricting prepayment penalties. The problem is the fact that pursuant to DIDMCA that authority was specifically reserved to the States. This must be balanced against the general preemption found by the Court in the Parity Act. The problem with the Court's interpretation is that a prepayment penalty is not inherent in any type of alternative mortgage. In fact this position has been explicitly rejected by the OTS when it adopted its revised rules in 2002. 67 Fed. Reg. 20470 (April 25, 2002) (App. 140) and 67 Fed. Reg. 60545 (September 26, 2002) (App. 176) This analysis was used by the court in *First Gibraltar Bank, FSB v. Morales,* 19 F.3d 1032 (5th Cir. 1994), if a law impedes the making of an alternative mortgage such as the Texas Homestead law which made reverse mortgages impossible, the state law must yield. Under DIDMCA, a state may at any time adopt a law which restricts discount points, finance charges, and other charges such as prepayment penalties and late charges. New Jersey was specifically authorized by Congress in the limited opt out provision of DIDMCA to

regulate points, late charges, attorneys fees and prepayment penalties. To suggest otherwise would be to render the limited opt out provision of DIDMCA a nullity. This interpretation is supported by the OTS as they noted in footnote 19 that the Parity Act makes no reference to fees or penalties.

> ***It is of note that the Parity Act makes no reference to fees and penalties nor does it direct federal regulators to consider their impact on alternative mortgages. 67 Fed. Reg. 20470 (September 26, 2002)***

AMPTA loans are not exempt from DIDMCA. It is important to note that the Parity Act must be read in conjunction with DIDMCA. 12 U.S.C. §3805 of AMPTA states that section 501(c)(1) of DIDMCA shall not apply to transactions which are subject to this chapter. This is important because that is the only part of DIDMCA where Parity Act loans are exempted. Section 501(c)(1) is the portion of the act concerning OTS consumer protection regulation of loans secured by mobile homes.

Congress was aware of its actions and only exempted alternative mortgage transactions (AMTS) from a small portion of DIDMCA. Congress could have easily stated that all Parity Act loans would be exempt from the opt-out provisions of DIDMCA. Congress chose not to do so. New Jersey was specifically authorized by Congress in the limited opt-out provision of DIDMCA to regulate interest, discount points, late charges, attorney's fees, prepayment penalties and other loan related charges. To suggest otherwise would be to render the limited opt-out provision of DIDMCA a nullity. Congress is presumed to know statutes it has passed and "absent a clear manifestation of contrary intent, a newly enacted statute is presumed to be

harmonious with existing law." *U.S. v. Langley*, 62 F.3d 602, 605 (4th Cir. 1995) *en banc, cert. denied*, 116 S.Ct. 797 (1996).

DIDMCA provides for a regulation of interest and its component charges. AMPTA provided for a different type of mortgage loan other than traditional 30 year fixed rate mortgages such as variable rate mortgages, balloon mortgages and reverse mortgages which were not generally available in many states in 1982. The issue in this case concerns loans which were clearly governed by both laws. The courts have uniformly held that the scope of DIDMCA is broad and Congress specifically reserved to the States the option to regulate these charges. *See Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 907 (3rd Cir. 1990).

As of this date the courts have refused to address the issue of the scope and effect of the opt-out provision of DIDMCA. The court should grant this petition to address this issue.

II. This court should confirm that the 1996 OTS regulations were ultra vires as the OTS has admitted.

The court should grant this petition for a Writ of Certiorari in order to close a tremendous regulatory hole which has allowed predatory lending to flourish.

Justice Zazzali in his dissent below crystallized the issue when he wrote:

> *"I write further only to underscore the point that affording lenders protection under the 1996 regulation, which by now has been universally recognized as misguided, becomes especially unjust*

when viewed in conjunction with the sequence of events relating to the "opt-out" mechanism provided by Congress when it enacted the underlying legislation.

In passing the Parity Act, Congress afforded each State 3 years to assert its right not to be pre-empted by the federal regulatory scheme.

12 U.S.C.A. 3804. *Congress enacted the law including that provision in 1982, some fourteen years before the suspect 1996 regulation was promulgated. During the three year window from 1982 to 1985, neither the New Jersey legislature nor that of any other State could predict that the OTS, or any other regulatory agency, someday would turn the salutary congressional goal of ensuring the availability of alternative mortgages on its head by sanctioning what arguably amounts to predatory lending practices by state chartered institutions. As explained by Judge King, the countenance of those practices, by the federal regulations' own admission, finds no support in the intent manifested by Congress when it enacted the Parity Act. That such ultra vires regulation came into being only after the states were no longer free to exempt themselves, compounds the injustice of allowing such lending practices the safe haven accorded by pre-emption in these circumstances."*

Id. at 73.

It is rare that any agency will candidly admit that a prior action taken was outside the scope of its legislative authority. Such a statement should not be lightly ignored. The OTS wrote:

> *"One of the congressional findings underlying the Parity Act was that OTS and other federal regulators had adopted regulations authorizing their federally chartered institutions to offer alternative mortgages, and that the purpose of the Act was to eliminate the discriminating impact of those regulations. OTS regulations on prepayment penalties and late fees, however, were not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts the flexibility to exercise their lending powers in a uniform federal scheme. See 12 C.F.R. 560.2(a). Therefore, OTS does not believe that Congress intended that regulations such as these would offer a basis for claiming discriminatory treatment or were needed to provide parity with federally charted institutions."* 67 Fed. Reg. 20470 (April 25, 2002) (Appendix at 140).

When the OTS later adopted the final rule in September of 2002, it had not changed its position in this regard as it wrote:

> *"If Congress had viewed the regulation of prepayment penalties as essential to parity, it is unlikely that Congress would have imposed a regulatory scheme that, at the time of its enactment, ensured different treatment among the various state creditors."* 67 Fed. Reg. 60545-60546 (September 26, 2002) (Appendxi at 176-177).

OTS has agreed that its belated 1996 "Clarification" was unauthorized and contrary to the federalism principles stressed in recent decisions of this Court.

Chevron Deference Is Inappropriate.

The OTS is not entitled to deference under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984). *Chevron* requires a two-part test: first, the Court inquires whether the plain language of the statute addresses the precise issue. If so, that is the end of the matter, because courts as well as agencies must give effect to the unambiguously expressed intent of Congress. *Id.* If, however, the statute is silent or ambiguous, the agency's interpretation will be upheld if it is a permissible construction of the statute – so long as it is a matter within the agency's authority. *Id.*

In determining whether a statute is ambiguous, a court is guided by reference to the language itself, the context in which the language is used, and the broader context of the statute as a whole. *U.S. v. Wilkes*, 120 F.3d 468, 469-70 (4th Cir. 1997), *cert. denied sub nom. Cameron v. U.S.*, 115 S.Ct. 885 (1998). The Parity Act provision at issue is whether "An (AMT) may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law or regulation." 12 U.S.C. §3803(c). The plain meaning of those words is that State Laws that would prevent AMTs from being made are preempted, and that State laws that do not interfere with the making of AMTs are not preempted. The broader context of the statute itself compels this result: the purpose of the Act was to foster the making of AMTs by nonfederal lenders. There is no other purpose described in Section 3801(9b) that would envision preemption of State laws beyond those that prevent the making of AMTs. Hence, the federal statute not being ambiguous, there is nothing for OTS to construe; State laws regulating prepayment penalties do not obstruct the making of AMTs

and, therefore, are not preempted by Section 3803(c). This position has been echoed by the OTS in its recent rulemaking.

> *One of the congressional findings underlying the Parity Act was that OTS and other federal regulators had adopted regulations authorizing their federally charted institutions to offer alternative mortgages, and that the purpose of the Act was to eliminate the discriminatory impact of those regulations. OTS regulations on prepayment penalties and late fees, however, were not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts the flexibility to exercise their lending powers in a uniform federal scheme. See 12 C.F.R. 560.2(a). Therefore, OTS does not believe that Congress intended that regulations such as these would offer a basis for claiming discriminatory treatment or were needed to provide parity with federally charted institutions.*

Yet even if the Parity Act's silence were found to be ambiguous on the subject of prepayment penalties, the OTS would still not be entitled to deference. Its conclusion in 1996 that State laws regulating prepayment penalties were preempted by the Parity Act was (i) flatly inconsistent with its own then – effective regulations, which were limited to those that described and defined AMTs, *see* 48 Fed. Reg. 23053, and (ii) an impermissible construction of the Parity Act, because it would render the Act's opt-out provision a nullity, *see infra*. The OTS's 1996 opinion on preemption is also rebutted by another section of the Garn Act of which the Parity Act is a part, 12 U.S.C. §1701j-3, which expressly preempted State due-on-sale restrictions. The legislative history shows that Congress recognized the extraordinary intrusion into state police

powers accomplished by preemption, and set out in fine detail its reasons for doing so. Excerpts from Senate Report, pp. 3074-79, 3110-12. In that manner, Congress made known its "clear and manifest purpose" to preempt due-on-sale restrictions in 12 U.S.C. §1701j-3. *Compare* Section 1701j-3 with the sharply focused language of Section 3803(a)(3) and Section 807 of the Parity Act. Congress said nothing about preempting State prepayment penalty laws either in the Parity Act or its legislative history, even though prepayment penalty statutes are similar to due-on-sale restrictions as exercises of state police power over lending practices. Had Congress intended to preempt State laws governing prepayment penalties in the Parity Act, surely there would be at least a fingerprint in the legislative history so indicating.

Moreover, when the issue is whether Congress has preempted or authorized preemption of State law, it is inappropriate for courts to grant deference under *Chevron*. *See Brown & Williamson Tobacco Corp. v. FDA,* 153 F.3d 155, 162 (4th Cir. 1998) (Court should strictly scrutinize agency interpretations of its own authority), *cert. granted*, 119 S.Ct. 1495 (1999); *Commonwealth of Virginia Department of Education v. Riley,* 106 F.3d 559, 565 n.4, 566-67 (4th Cir. 1997) *en banc* (*Chevron* deference inappropriate when congressional authorization principal issue for decision).

In this case, treating New Jersey in a manner consistent with her constitutional status requires the court to make an effort to reconcile federal and state statutory schemes, rather than ousting New Jersey's Consumer Protection limitations. Here, as in other cases involving overlapping federal and state consumer protection legislation, express statutory language of preemption is to be

interpreted narrowly, with a presumption against preemption of the historic police powers of states. This correct approach is illustrated in recent decisions of the Supreme Court of the United States. For example, in the context of employee benefits, the Supreme Court has rejected an expansive view of preemption and instead applied language of express preemption more strictly, with a "presumption against preemption" of state law alleged to conflict with ERISA. *See New York Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, 514 U.S. 645, 655 (1995); *California Division of Labor Standards Enforcement v. Dillingham Construction, N.A., Inc.*, 519 U.S. 316, 331-32 (1997). The plain language of section 3803(c) considered in light of the history and structure of the Parity Act, and the presumption against preemption, supports the conclusion that Congress did not authorize the 1996 regulatory action of OTS, making *Chevron* deference inappropriate: [a] precondition to deference under *Chevron* is a congressional delegation of administrative authority. No deference is due the [agency] construction of the Act unless it is acting within the bounds of its congressionally-established authority." *Brown & Williamson Tobacco*, 153 F.3d at 161 (citation omitted). *Accord, Int'l Assoc. of Indep. Tanker Owners v. Locke*, 148 F.3d 1053, 1067 (9th Cir. 1998) ("Preemption by regulations enacted by a federal agency does not occur if that agency is acting beyond the scope of its delegated powers"), *cert. granted*, 68 U.S.L.W. 3152 (1999). As noted previously, the OTS has conceded this in its effort to correct the regulations.

Defendant Equity One has cited *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996) and *Fidelity Federal Savings and Loan Ass'n v. De La Cuesta*, 458 U.S.

141, 153-54 (1982). However, these cases are inapposite, because they do not involve interpretation of express statutory language of preemption setting forth the intent of Congress: *See Cipollone v. Liggett Group Inc.*, 505 U.S. 504, 517 (1992) ("When Congress has considered the issue of preemption and had included in the enacted legislation a provision explicitly addressing that issue, and when that provision provides a reliable indicium of congressional intent with respect to state authority, there is no need to infer congressional intent to pre-empt state laws from the substantive provisions of the legislation") (citations omitted); *accord, Casino Ventures v. Stewart*, 183 F.3d 307, 312 (1999), *cert. denied*, 528 U.S. 1077 (2000) (express preemption provisions are "strong evidence that Congress did not wish to extend preemption any further") (quoting *Cipollone*, 505 U.S. at 517; *Lowe v. Sporicidin International*, 47 F.3d 124, 128 (4th Cir. 1995) ("It seems clear to us that the Supreme Court's preemption analysis in *Cipollone* makes it clear that our narrower view of FIFRA preemption is preferable.")

Fidelity Federal concerned a regulation for federal thrifts issued by the Federal Home Loan Bank Board under a broad grant of rulemaking authority in the Home Owner's Loan Act of 1933 ("HOLA"). *See* 12 U.S.C. §1464(a). The Court held that a regulation preempting state limitations on due-on-sale clauses was a valid exercise of the FHLBB's plenary regulatory authority with respect to federal savings and loans: "The language and history of HOLA convince us that Congress delegated to the Board, ample authority to regulate the lending practices of federal savings and loans so as to further the Act's purposes, and that **c** is consistent with those purposes". 458 U.S. at 159.

In contrast, the Parity Act contains no such broad grant of authority for OTS to issue regulations for state-chartered mortgage companies. Rather, Congress strictly limited the task assigned the OTS in the Parity Act to assure States an opportunity to make an informed choice and participate jointly in the regulation of AMTs by state-chartered housing creditors. Moreover, even OTS admitted that its 1996 regulation was not an exercise of plenary regulatory authority, but a mere clarification of the Parity Act, "to eliminate possible confusion."

Smiley concerned a regulation for national banks issued by the OCC under a broad grant of rulemaking authority in the National Bank Act. The Court held that a regulation interpreting the word "interest" preempted state law. However, the Court emphasized that it was not dealing with the question of whether a statute is preemptive, and it recognized that a statutory provision dealing with preemption would implicate the presumption against preemption and the clear statement rule. *See Smiley*, 517 U.S. at 743-44 (citing *Cipollone*, 505 U.S. at 518).

In contrast, this case concerns express language of preemption in 12 U.S.C. §3803(c) and a statutory design that evinces clear congressional intent not to disturb state laws that do not prevent or significantly interfere with the ability of housing creditors to make, purchase and enforce AMTs. The case against preemption is especially strong where – as here – the federal and state schemes are so manifestly compatible. New Jersey's longstanding limitations on prepayment penalties existed alongside federal statutes and regulations for more than a decade before OTS announced its novel "clarification" in 1996. New Jersey's limitations on prepayment penalties

never prevented or obstructed state chartered housing creditors from making AMTs.

Congress is presumed to know what statutes it has passed, and "absent a clear manifestation of contrary intent, a newly enacted . . . statute is presumed to be harmonious with existing law. . . . " *U.S. v. Langley*, 62 F.3d 602, 605 (4th Cir. 1995) *en banc*, *cert. denied*, 116 S.Ct. 797 (1996). The existing (in 1982) NCUA statute (the Federal Credit Union Act – 12 U.S.C. §1757(5)(A)(viii) – barred the imposition of prepayment penalties. The Parity Act may most easily and logically be harmonized with that law by interpreting the Parity Act not to have any effect on State Laws limiting prepayment penalties.

The Parity Act provided that States could opt out from a preemption provision of Section 3803 within three years from October 15, 1982. Section 3804. New Jersey did not do so because AMTs were already legal in New Jersey. Indeed, when the opt out window closed in 1985, the regulations identified by the FHLBB in its three Notices to Housing Creditors not only failed to preempt State laws regulating prepayment penalties, they specifically stated that federal regulations of general application to mortgage loans were not applicable to AMTs. 48 Fed. Reg. 25053.

Since the OTS waited until 1996 to opine that State laws regulating prepayment penalties were preempted by the Parity Act, a state legislature would need the powers of Nostradamus to have known in October 1985 – when the "opt-out window" closed that it should opt out from a federal intrusion into state law not to be accomplished for eleven years. The OTS has now even suggested that Congress should allow a new period for opt-out from the Parity Act for this very reason.

This Court should reject the notion that in passing the Parity Act, Congress would "sandbag" the States, giving them three years to opt out from a preemption that was not defined until 1996, after the opt-out period had expired. Such a bizarre interpretation must be shunned, whether advanced in the belief that Congress intended to sandbag the States, or in the belief that State statutes can be vitiated by an agency opinion issued eleven years after the fact (an opinion flatly inconsistent with the regulations that were contemporaneously adopted). A finding of preemption is inconsistent with the notice of concurrent sovereignty. *See Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991). Moreover, to countenance such a disingenuous method of preemption would contravene the principle that preemption of State laws is not a power that is exercised lightly. *Id.* 501 U.S. at 460. It would render the "clear statement" rule meaningless to allow an agency to decide after the opt-out window closes that State law is preempted in a brand new area. *See Gregory*, 501 U.S. at 461: the clear statement rule assures that Congress "has in fact faced, and intended to bring into issue, the critical matters involved in the judicial decision."

In addition, the opt-out provision provides that States could opt out from the preemption accomplished by the Act. *See* Section 3804: States may opt out if "such State does not want the preemption *provided in section 3803 of this title to apply* to AMTs" (emphasis supplied). The underlined words would be meaningless if Congress intended preemption to occur either (i) by federal agency, or (ii) after the opt-out window closed. Surely, Congress meant that States would be able to make a knowing decision about whether to opt out. *Pennhurst v. State School & Hospital v. Halderman*, 451 U.S. 1, 17 (1981).

Novel regulatory interpretations that expand agency jurisdiction are not entitled to deference. *Brown & Williamson Tobacco Corp.*, 153 F.3d at 155, 163, 168, 170, n.18 (rejecting novel interpretation expanding regulatory jurisdiction 60 years after passage of statute).

New Jersey consumers have always been able to obtain AMTs and New Jersey's ban on prepayment penalties has in no way limited their AMT options and alternatives. Moreover, the NCUA statute barred the imposition of prepayment penalties before passing the Parity Act. But even beyond this inconsistency, the OTS itself has recognized that the New Jersey Statutes protect consumers. *See* 12 C.F.R. §590(3)(c), dealing with state usury laws: "Nothing in this section preempts limitation in state laws on prepayment charges . . . or other provisions *designed to protect consumers.*" (emphasis supplied). Indeed, that very regulation lends support to the view that Congress is sufficiently familiar with the importance of State laws regulating prepayment penalties that it would not preempt such laws in such an indirect manner.

It is important to recognize that there is no established federal policy requiring uniformity or disfavoring limitations on prepayment penalties as a means of increasing the availability of credit. Congress allowed states to opt out of identified federal regulations, which several states did, rebutting any argument based on uniform national standards for AMTs. Moreover, although the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. §1735f-7a, preempted many State laws affecting first mortgage loans, Congress chose to allow the States to opt out of the act and re-regulate interest and interest charges, a field left

historically to State control. *See Currie v. Diamond Mortgage Corp. of Ill.*, 859 F.2d 1538, 1541-43 (7th Cir. 1988).

As noted above, Congress has also made the policy determination that federal credit union borrowers should be permitted to prepay their loans without penalty, 12 U.S.C. §1757(5)(A)(viii). It also has prohibited prepayment penalties as a condition of eligibility for insurance of home equity conversion mortgages for elderly homeowners. 12 U.S.C. §1715z-20(d)(4). Thus, it cannot be said that federal policy disfavors limitations on prepayment penalties as a means of increasing credit availability. *See* Senate Report 97-463, *Housing and Community Development Amendments of 1982* (Filed May 12, 1982) p. 55:

> *"Through the Parity Act . . . housing creditors . . . are being authorized to engage in transactions in accordance with regulations issued by those federal agencies for the institutions that they charter. This does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to State Law."*

The federal "program" is the ability to make AMTs which in 1982 many States did not permit. That is why the federal program was an alternative to State law. Under federal law, loans made under NCUA authority could not impose prepayment penalties. 12 U.S.C. §1757(5)(A)(viii). Hence, if AMTs made through the NCUA were forbidden to impose prepayment penalties, the federal "program" envisioned by Congress could not be a program that required the ability to impose prepayment penalties as a necessary component.

Here, the core issue is about who has the authority to make important policy decisions. This Court should not conclude that the Parity Act's silence on prepayment penalties conferred a license to regulate on OTS and the federal court to substitute their judgments for those of State legislatures. The Parity Act, properly read, respects State sovereignty and gives effect to the important State interests served by New Jersey's consumer protection statutes, without significantly interfering with the ability of housing creditors to make, purchase and enforce AMTs. As Judge King wrote:

> *We agree with the reasoning set forth in the OTS's Notice of Proposed Rulemaking. In accordance with that reasoning, we find that 12 C.F.R. § 560.220 is invalid to the extent it incorporates 12 C.F.R. § 560.34, thereby regulating prepayment penalties assessed by state-chartered housing creditors on AMTs covered by the Parity Act. Furthermore, as will be discussed, in our opinion, Shinn, Face, and Benay, as well as the OTS 1996 Opinion Letter, were incorrectly decided because they did not give proper consideration to: (1) Congress's limited purpose in passing the Parity Act, to create a national market for AMTs; or (2) Congress's limited intent, through the Parity Act's preemption provision, to preempt only those state laws which prohibit or interfere with a housing creditor's ability to make, purchase, or enforce AMTs.*
>
> *We hold that, to the extent 12 C.F.R. § 560.220 incorporates the regulation of prepayment penalties under 12 C.F.R. § 560.34, and applies 12 C.F.R. § 560.34 to AMTs issued by state-chartered housing creditors, it is unlawful, because it exceeds the scope of authority Congress delegated to the OTS*

under the Parity Act. Id., 360 N.J. Super. 1 at 36 (App. Div. 2003).

CONCLUSION

Predatory lending has become rampant across the country. The OTS and the Courts have observed that prepayment penalties are the primary tool used by these lenders to prey on consumer borrowers. States such as New Jersey have attempted to protect their citizens by passing laws prohibiting such charges pursuant to the opt-out provision of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) 12 U.S.C. §1735(f)-7(a). Only to be frustrated in their attempt to enforce such laws the Court should grant this writ of certiorari to hold that the OTS regulations under AMPTA do not preempt these laws.

Respectfully submitted,

LEWIS G. ADLER, ESQ.

ROGER C. MATTSON, ESQ.

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SUPREME COURT OF NEW JERSEY
A-22 September Term 2003

MARK GLUKOWSKY,

Plaintiff-Respondent,

v.

EQUITY ONE, INC., a Delaware Corporation,

Defendant-Appellant.

Argued February 3, 2004 – Decided May 26, 2004

On certification to the Superior Court, Appellate Division, whose opinion is reported at 360 *N.J. Super.* 1 (2003).

Mark S. Melodia argued the cause for appellant (*Reed Smith, attorneys*; *Mr. Melodia* and *Lauren Graham Delehey*, on the brief).

Lewis G. Adler argued the cause for respondent (*Mr. Adler*, attorney; *Mr. Adler*, *Roger C. Mattson* and *Louis D. Fletcher*, on the briefs).

Dennis R. Casale argued the cause for *amicus curiae* Mortgage Bankers Association of New Jersey (*Levy & Watkinson* and *Pepper Hamilton*, attorneys; *Mr. Casale* and *E. Robert Levy* of counsel; *Mr. Casale*, *Mr. Levy* and *Michael G. Petrone*, on the brief).

David McMillin argued the cause for *amicus curiae* Legal Services of New Jersey (*Melville D. Miller, Jr.*, President, attorney; *Mr. McMillin*, *Carrie Ferraro*, *Gwen E. Orlowski* and *Rebecca Shore*, on the brief).

William H. Hyatt, Jr. submitted a brief on behalf of *amicus curiae* National Home Equity Mortgage Association (*Kirkpatrick & Lockhart*, attorneys).

Michael M. Horn submitted a brief on behalf of *amici curiae* American Bankers Association, American Financial Services Association, America's Community Bankers, Consumer Bankers Association, Consumer Mortgage Coalition, Mortgage Bankers Association of America, New Jersey Financial Services Association and New Jersey ~~League of~~ Community Bankers (*McCarter & English*, attorneys; *Mark D. Knoll*, on the brief).

JUSTICE ALBIN delivered the opinion of the Court.

In 1996, the federal Office of Thrift Supervision (OTS) issued a regulation authorizing state housing lenders to charge prepayment penalties in alternative mortgage transactions (AMT). Alternative Mortgage Transaction Parity Act, 12 *C.F.R.* § 560.220 (1996). That regulation would preempt our state laws that prohibit housing lenders from charging prepayment penalties. Plaintiff contends that OTS exceeded the scope of authority delegated to it by Congress under the Alternative Mortgage Transaction Parity Act of 1982, 12 *U.S.C.A.* §§ 3801-06 (Parity Act), when it issued 12 *C.F.R.* § 560.220. In determining whether that federal regulation is valid, we address principles concerning the scope of authority granted to a regulatory agency, preemption, and comity.

I.

In 1999, plaintiff Mark Glukowsky secured a $72,000 mortgage loan from defendant Equity One to finance the purchase of a home in Mount Laurel. The financing

arrangement provided a fixed-interest rate over a ten-year term at the end of which the loan, though not fully amortized, would mature. On the maturity date in 2009, plaintiff would owe $62,021.25 of the principal and have the choice to pay the entire principal or refinance the loan with Equity One or another lender. This method of financing a residential mortgage is commonly referred to as a "balloon loan" and constitutes an AMT under the Parity Act. An AMT is a loan with an interest rate or finance charge that may be adjusted or renegotiated; a loan with a fixed-interest rate that matures before it is fully amortized, thus implicitly permitting rate adjustments; or a loan with other variations "not common to traditional fixed-rate, fixed-term transactions." 12 *U.S.C.A.* § 3802(1).

As part of the mortgage contract, plaintiff agreed to pay a prepayment fee to Equity One if he repaid the loan in full during the first three years of its term.[1] The mortgage contract also contained a "due on sale" clause, providing that if the mortgaged property was sold or transferred without Equity One's prior written consent, the full amount of the loan would be due on demand. In 2001, plaintiff sold the Mount Laurel residence subject to the mortgage and "due on sale" clause. Equity One exercised its right to demand full payment of the loan and sent plaintiff a pay-off statement. That statement included a two percent prepayment fee in the amount of $1,427.97 because the outstanding balance on the loan was to be

[1] Under the terms of the Prepayment Rider, full repayment of the loan in the first year would result in a prepayment fee equal to three percent of the amount being prepaid, in the second year a two percent fee, and in the third year a one percent fee.

paid within the second year of the mortgage term. Plaintiff paid the prepayment fee under protest.

Plaintiff later filed a complaint alleging that Equity One had violated New Jersey's Prepayment Penalty Law, *N.J.S.A.* 46:10B-2, Market Rate Consumer Loan Act, *N.J.S.A.* 17:3B-22, and Consumer Fraud Act, *N.J.S.A.* 56:8-2, by collecting the prepayment fee. Equity One moved to dismiss the complaint on the ground that it was preempted by 12 *C.F.R.* § 560.220, which barred enforcement of any state law that prohibited a state-chartered lending institution from charging a prepayment fee on an AMT.

Before the promulgation of 12 *C.F.R.* § 560.220 by OTS in 1996, federal lenders were free to charge prepayment fees on AMTs pursuant to 12 *C.F.R.* § 560.34, while state lenders, such as Equity One, were subject to state laws, many of which prohibited prepayment fees in real estate transactions. The adoption of 12 *C.F.R.* § 560.220 placed state-chartered housing creditors on an equal footing with their federal counterparts by extending 12 *C.F.R.* § 560.34 to state lenders and preempting any state law that forbid charging a prepayment fee on an AMT. The Law Division found that 12 *C.F.R.* § 560.220 barred enforcement of New Jersey's Prepayment Penalty Law and dismissed the complaint on the basis of federal preemption.

The Appellate Division reversed and held that OTS exceeded the scope of its authority under the Parity Act when it applied 12 *C.F.R.* § 560.34 to state lending institutions engaged in AMTs. *Glukowsky v. Equity One, Inc.*, 360 *N.J. Super.* 1, 12 (2003). The panel concluded that Congress did not intend the Parity Act to preempt state

consumer protection laws that prohibited the imposition of prepayment fees on real estate transactions in general, and on AMTs in particular. *Id.* at 37-39. The panel reinstated the claims that alleged violations of New Jersey's Prepayment Law and Consumer Fraud Act, but affirmed the dismissal of the claim arising under the Market Rate Consumer Loan Act because that statute did not apply to defendant. *Id.* at 48. Plaintiff was allowed to amend his complaint to allege other claims arising under federal and state law.[2] *Ibid.* The panel did not address whether to apply its decision retroactively, leaving that issue to be developed on remand. *Ibid.*

We granted Equity One's petition for certification. 177 *N.J.* 575 (2003). We also granted the motions of the American Bankers Association, *et al.*,[3] the National Home Equity Mortgage Association, the Mortgage Bankers Association of New Jersey, and Legal Services of New Jersey for leave to participate as *amici curiae.*

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[2] In his brief before the Appellate Division, plaintiff argued for the first time that defendant's collection of a prepayment penalty violated the federal due-on-sale regulation, 12 *C.F.R.* § 591.5(b)(2)(i); the New Jersey Licensed Lenders Act, *N.J.S.A.* 17:11C-1 to -49; and general contract law principles prohibiting unconscionable contract terms. *Glukowsky, supra,* 360 *N.J. Super.* at 10. Plaintiff neither pleaded those claims in his complaint nor moved to amend the complaint to state such claims. *Id.* at 10-11. Nevertheless, after reinstating the complaint, the Appellate Division allowed plaintiff to amend the complaint to assert those new claims. *Id.* at 47.

[3] Amici are American Bankers Association, American Financial Services Association, America's Community Bankers, Consumer Bankers Association, Consumer Mortgage Coalition, Mortgage Bankers Association of America, New Jersey Financial Services Association, and New Jersey League of Community Bankers. Those organizations represent mortgage lenders who make and service mortgage loans in New Jersey and nationwide.

The central issue in this case is whether the Parity Act gave OTS the authority to adopt the challenged regulation. To determine whether 12 *C.F.R.* § 560.220 is a valid expression of legislative authority, we first turn to the history of the Parity Act and the rule adopted by OTS.

II.

A.

In the late 1970s and early 1980s, an increasingly volatile interest rate market seriously impaired the ability of housing creditors to provide consumers with fixed-term, fixed-rate mortgages secured by residential property. *Nat'l Home Equity Mortgage Ass'n v. Face,* 239 *F.*3d 633, 635 (4th Cir.), *cert. denied,* 534 *U.S.* 823, 122 *S. Ct.* 58, 151 *L. Ed.* 2d 26 (2001); 12 *U.S.C.A.* § 3801(a)(1). Those market conditions made it exceedingly difficult for consumers to obtain and afford credit for the purchase of a home. *See Grunbeck v. Dime Sav. Bank of N.Y., FSB,* 74 *F.*3d 331, 343 (1st Cir. 1996).

In response to the precarious state of the residential mortgage market, "Congress enacted the Garn St. Germain Depository Institutions Act of 1982 to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and ensuring the availability of home mortgage loans." *Face, supra,* 239 *F.*3d at 635 (internal quotation marks omitted). Title VIII of that legislation, the Parity Act, allowed state-chartered housing creditors to offer alternative mortgages if they agreed to operate in accordance with federal regulations. *Ibid.* (citing S. Conf. Rep. No. 97-641, at 94 (1982), *reprinted in* 1982 U.S.C.C.A.N. 3128, 3137). The ability of state lending institutions to issue AMTs was seen by

Congress as essential to ensure the nation an adequate supply of housing credit. 12 *U.S.C.A.* § 3801(a)(2). Before passage of the Parity Act, federally-chartered lenders were authorized to engage in alternative mortgage financing. *See* 12 *U.S.C.A.* § 3801(a)(3). However, twenty-six states either prohibited state-chartered lenders from engaging in AMTs or imposed on those lenders burdensome restrictions. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 60,542, 60,543 (2002) (to be codified at 12 *C.F.R.* § 560.220) [hereinafter *2002 Final Rule*].

The express legislative purpose of the Parity Act is

> to eliminate the discriminatory impact that [federal] regulations [authorizing federally chartered housing creditors to engage in AMTs] have upon nonfederally chartered housing creditors and provide them *with parity* with federally chartered institutions by authorizing all housing creditors *to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.*

[12 *U.S.C.A.* § 3801(b) (emphasis added).]

To achieve the goals of the Parity Act, Congress granted to the Federal Home Loan Bank Board (FHLBB), the predecessor to OTS, and two other federal agencies, the rulemaking authority "to prevent discrimination against" state-chartered lending institutions engaged in "making, purchasing, and enforcing alternative mortgage transactions."[4] 12 *U.S.C.A.* § 3803(a)(3). That rulemaking

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[4] State-chartered banks and state-chartered credit unions must comply with regulations issued by the Comptroller of the Currency for national banks and the National Credit Union Administration Board

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authority included the power to promulgate regulations in furtherance of the Parity Act "notwithstanding any State constitution, law, or regulation." 12 *U.S.C.A.* § 3803(a)(3) and (c). In 1989, the statute was amended to substitute OTS for the FHLBB as the agency regulating state-chartered housing lenders. Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 744(c), 103 Stat. 183 (1989) (codified at 12 *U.S.C.A.* § 3801(a)(3)).

States were not bound involuntarily to the Parity Act. Those states wishing to opt-out of the Act's preemption provisions only needed to certify an intention to do so within three years of its passage. 12 *U.S.C.A.* § 3804. New Jersey did not avail itself of that option. *Glukowsky, supra,* 360 *N.J. Super.* at 21. By not exiting the federal program within the three-year period, the State necessarily agreed to follow all applicable federal regulations, those in existence then and those to be adopted in the future.[5]

Congress directed OTS to "identify, describe, and publish those portions of [its] regulations that are inappropriate for (and thus inapplicable to) . . . nonfederally

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for federal credit unions, respectively. 12 *U.S.C.A.* § 3803(a)(1) and (2). All other non-federally-chartered housing creditors lending in reliance on the Parity Act must comply with regulations issued by OTS, or its predecessor, FHLBB. *Id.* § 3803(a)(3).

[5] Our dissenting colleagues suggest that, because the New Jersey Legislature did not anticipate OTS's adoption of 12 *C.F.R.* § 560.220, the regulation is infirm. However, when the states agreed to be bound by the federal regulatory framework involving the Parity Act, those states necessarily agreed to follow all applicable federal regulations in furtherance of the Parity Act. The states knew that they could not exit the program merely because they disagreed with a particular federal regulation. Nowhere in this record is there a suggestion that New Jersey would have opted out had it known that OTS would adopt 12 *C.F.R.* § 560.220.

chartered housing creditors."[6] Pub. L. No. 97-320, § 807(b), 96 Stat. 1469 (1982). Based on the broad rulemaking authority delegated to it pursuant to 12 *U.S.C.A.* §§ 1463(a)(2), 1464(a) of the Home Owners' Loan Act, 12 *U.S.C.A.* § 3803(a)(3), and § 807(b) of the Parity Act, OTS in 1996 adopted 12 *C.F.R.* § 560.220, giving state-chartered housing lenders the same authority to impose prepayment penalties on AMTs already possessed by their federal counterparts. *Face, supra,* 239 *F.*3d at 640; *Shinn v. Encore Mortgage Servs., Inc.,* 96 *F. Supp.* 2d 419, 423-24 (D.N.J. 2000).

12 *C.F.R.* § 560.220 extended the benefit of four federal regulations to state-chartered housing lenders engaged in AMTs, "notwithstanding any state constitution, law, or regulation."[7] Only one of those regulations, 12

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[6] The FHLBB in 1983 issued a Final Rule that identified three of its regulations that "describe and define" AMTs, and thus also would be applied to state-chartered housing creditors: § 545.33(c), granting authority to engage in AMTs; § 545.33(e), limiting adjustments to loans secured by borrower-occupied property; and § 545.33(f)(4)-(11), imposing disclosure requirements on AMTs secured by borrower-occupied property. *Implementation of New Powers; Limitation on Loans to One Borrower,* 48 *Fed. Reg.* 23,032, 23,053 (1983). The FHLBB deemed all of its other regulations to be inappropriate and, therefore, inapplicable to AMTs. *Ibid.* The FHLBB did not identify any regulations that applied to mortgage loans generally, and specifically did not apply its regulations regarding prepayment penalties to state-chartered lenders. *Ibid.*

[7] The version of 12 *C.F.R.* § 560.220 made effective October 30, 1996 provided:

> Pursuant to 12 *U.S.C.* 3803, housing creditors that are not commercial banks, credit unions, or Federal savings associations may make alternative mortgage transactions as defined by that section and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, 12 *U.S.C.*

(Continued on following page)

C.F.R. § 560.34, is relevant to this case. That regulation provides:

> Any prepayment on a real estate loan must be applied directly to reduce the principal balance on the loan unless the loan contract or the borrower specifies otherwise. *Subject to the terms of the loan contract, a Federal savings association may impose a fee for any prepayment of a loan.*
>
> [12 *C.F.R.* § 560.34 (emphasis added).]

By applying 12 *C.F.R.* § 560.34 to state lenders issuing AMTs, 12 *C.F.R.* § 560.220 clearly preempted enforcement of New Jersey's Prepayment Penalty Law.

The adoption of 12 *C.F.R.* § 560.220 followed a 1996 OTS opinion letter holding that by virtue of the Parity Act Wisconsin-chartered savings and loan associations issuing AMTs were not subject to that state's prepayment penalty law. *Effect of Parity Act on Wisconsin Prepayment Penalty Statute,* Op. Chief Counsel, OTS No. P-96-6 (Apr. 30, 1996). OTS reasoned that

> [i]f state housing creditors were required to follow the Wisconsin Statute when making variable-rate mortgage loans, they would clearly be disadvantaged vis-à-vis federal thrifts – the very

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3801 note, §§ 560.33, 560.34, 560.35, and 560.210 of this part are identified as appropriate and applicable to the exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable. Housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable.

[*Lending and Investment,* 61 *Fed. Reg.* 50,951, 50,983 (1996) (to be codified at 12 *C.F.R.* § 560.220) [hereinafter *1996 Final Rule*].]

> result Congress intended to prevent. The Wisconsin Statute thus appears to fall within the scope of laws preempted by the Parity Act. Accordingly, state savings associations and state housing creditors that are not state banks or credit unions and that originate variable-rate loans in conformity with all applicable OTS regulations need not comply with the Wisconsin Statute.
>
> [*Ibid.*]

Based on that analysis, 12 *C.F.R.* § 560.34 was made applicable to state lenders through 12 *C.F.R.* § 560.220.

In 2002, OTS proposed a rule change removing 12 *C.F.R.* § 560.34 from 12 *C.F.R.* § 560.220, thereby eliminating the preemption provision that barred enforcement of state prepayment laws against state lenders engaged in AMTs. During that rulemaking process, OTS reexamined the appropriateness of regulating prepayment fees and late charges relating to AMTs by state lenders. *See 2002 Final Rule, supra,* 67 *Fed. Reg.* 60,542; *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 20,468 (2002) (to be codified at § 560.220) (proposed Apr. 25, 2002) [hereinafter *2002 Notice of Proposed Rulemaking*]; *2000 Advance Notice of Proposed Rulemaking, supra,* 65 *Fed. Reg.* at 17,814. OTS acknowledged that whether Congress intended to preempt state laws governing prepayment fees fell within a "gray area." *2002 Notice of Proposed Rulemaking, supra,* 67 *Fed. Reg.* at 20,470. The Parity Act and its legislative history provided OTS with little direction as to which federal regulations were to apply to state-chartered housing creditors that engage in the making, purchasing, and enforcing of AMTs. *2002 Final Rule, supra,* 67 *Fed. Reg.* at 60,543. When OTS

decided to regulate prepayment fees in 1996 pursuant to the Parity Act, it did so believing that Congress intended to remedy the disadvantage to state-chartered institutions that flowed from differing federal and state laws regulating AMTs. 12 *U.S.C.A.* § 3801(b). By 2002, however, after 12 *C.F.R.* § 560.220 had been on the books for six years, OTS had knowledge that widespread use of prepayment penalties in sub-prime loans promoted predatory lending practices.[8] *2002 Final Rule, supra,* 67 *Fed. Reg.* at 60,547-48. In the year prior to passage of the Parity Act only about ten percent of sub-prime loans included prepayment penalties, but by 1999 that figure had risen to approximately seventy to seventy-six percent. *Id.* at 60,547 (citing data from the Joint HUD/Treasury Report on Recommendations to Curb Predatory Home Mortgage Lending (Apr. 20, 2000)). Anecdotal evidence also suggested that predatory lending practices disproportionately targeted minorities and the elderly. *Ibid.*

Because the 1996 OTS regulation preempted state laws prohibiting prepayment penalties only as applied to AMTs, it also had the unintended consequence of creating an incentive for state lenders to favor AMTs over traditional fixed-interest mortgages that still were subject to state prepayment penalty laws. *See 2002 Final Rule, supra,* 67 *Fed. Reg.* at 60,546; *2002 Notice of Proposed Rulemaking, supra,* 67 *Fed. Reg.* at 20,469. Last, OTS no longer accepted the "apparent rationale" for its 1996 rule

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[8] Sub-prime loans have higher interest rates than prime loans and typically are extended to borrowers whose past credit problems make them a higher risk. *Nat'l Home Equity Mortg. Ass'n v. OTS,* 271 *F. Supp.* 2d 264, 277 n.8 (D.C. Cir. 2003); *2000 Advance Notice of Proposed Rulemaking, supra,* 65 *Fed. Reg.* at 17,814.

that absent preemption of state prepayment laws "state housing creditors would be disadvantaged vis-à-vis federal thrifts." *Id.* at 60,543. Based on this new reality, OTS reasoned that state laws regulating prepayment fees and late charges should "reflect each state legislature's judgment, after due consideration, about appropriate consumer protections applicable to state-chartered lenders." *Id.* at 60,548. OTS would not "construe its authority under [the Parity Act] to frustrate these state efforts where another less intrusive construction of [the Parity Act] is permissible." *Ibid.*

In its *2002 Final Rule,* effective July 2003, OTS eliminated § 560.34 from the list of federal regulations applicable to state-chartered housing creditors, finding that a creditor's ability to assess prepayment fees was "not essential or intrinsic to the ability to offer alternative mortgages." *2002 Final Rule, supra,* 67 *Fed. Reg.* at 60,544. Nevertheless, OTS concluded in the 2002 Final Rule that its 1996 regulation was a permissible interpretation at the time. *Id.* at 60,550.

B.

In light of that legislative and regulatory history, we return to the rationale provided by the Appellate Division for holding that OTS acted without legislative authority in adopting the 1996 version of 12 *C.F.R.* § 560.220. The appellate panel sought to divine what Congress intended when it spoke in terms of state-chartered lending institutions achieving parity with federally-chartered institutions in "making, purchasing, and enforcing alternative mortgage transactions." *Glukowsky, supra,* 360 *N.J. Super.* at 27, 36-38; 12 *U.S.C.A.* § 3803(a)(3). Did Congress intend a

narrow purpose, preempting only those state laws that prohibited state lenders from marketing AMTs or did Congress have a more expansive purpose, achieving competitive equality between state- and federally-chartered lenders? The panel interpreted the Parity Act as having the limited purpose of preempting only those state laws that prohibited or restricted a state-chartered lending institution from marketing an AMT. *Glukowsky, supra,* 360 *N.J. Super.* at 40. The panel found that OTS had construed the purpose of the Parity Act too broadly by attempting to achieve "complete parity between federally and non-federally chartered housing creditors." *Id.* at 37. In the panel's view, Congress did not intend "that every AMT, throughout the nation, must contain, or at least offer, the same terms, down to the minutiae of regulating the fees and penalties which may be imposed." *Ibid.* Accordingly, the 1996 extension of 12 *C.F.R.* § 560.34 to state lenders was an impermissible interpretation of the Parity Act because the Act was not intended to create precise equality between state and federal lenders that issued AMTs.

Although the Appellate Division acknowledged that an agency's interpretation of a statute falling within its regulatory authority is entitled to deference, it found that the 1996 version of 12 *C.F.R.* § 560.220 was "'entitled to considerably less deference,'" because it represented a sharp change from the agency's prior interpretation of the Parity Act. *Id.* at 42-43 (quoting *Good Samaritan Hosp. v. Shalala,* 508 *U.S.* 402, 417, 113 *S. Ct.* 2151, 2161, 124 *L. Ed.* 2d 368, 383 (1993)). While noting that an agency may support a change of direction by a reasoned analysis, the panel concluded that the *1996 Final Rule* "was not supported by any reasoning at all." *Id.* at 32. The panel relied

on language in the *2002 Notice of Proposed Rulemaking*, in which OTS suggested that it had not explained sufficiently its reasons for adopting the 1996 rule and its departure from the prior standard of permitting state laws to regulate prepayment fees in AMTs. *Ibid.* (citing 67 *Fed. Reg.* at 20,470). The panel considered the language in OTS's *2002 Notice of Proposed Rulemaking* a tacit admission that it had exceeded the authority delegated to it by Congress in promulgating the 1996 regulation. *Id.* at 33. Reasoning that prepayment penalties do not prohibit or interfere with a housing creditor's ability to make, purchase, or enforce AMTs, the panel concluded that OTS never had authority to apply 12 *C.F.R.* § 560.34 to state-chartered lenders.

We disagree with the conclusion reached by the Appellate Division that OTS exceeded the authority Congress delegated to it in the Parity Act. Congress's intent is not entirely clear from the statutory language. We accept OTS's explanation that its 1996 rulemaking represented one permissible interpretation of the Parity Act. OTS is the agency responsible for enforcing the Parity Act and its interpretation of that Act is entitled to substantial deference. Moreover, the principle of comity instructs state courts to give due regard to a federal court's interpretation of a federal statute. *Dewey v. R.J. Reynolds Tobacco Co.*, 121 *N.J.* 69, 80 (1990). Federal courts uniformly have concluded that OTS in 1996 acted within the authority delegated to it by Congress by incorporating § 560.34 into 12 *C.F.R.* § 560.220 to allow state-chartered lenders to impose prepayment penalties in AMTs. *McCarthy v. Option One Mortgage Corp.*, 362 *F.*3d 1008, 1010-11 (7th Cir. 2004); *Nat'l Home Equity Mortgage Ass'n*

v. Face, supra, 239 F.3d at 639-40; *Shinn v. Encore Mortgage Servs., Inc., supra,* 96 *F. Supp.* 2d at 424, 426.

III.

The power of a federal statute to preempt a state law is derived from the Supremacy Clause of the United States Constitution. *U.S. Const.* art. VI., cl. 2; *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta,* 458 *U.S.* 141, 152, 102 *S. Ct.* 3014, 3022, 73 *L. Ed.* 2d 664, 674 (1982). Congress can pass legislation that either explicitly or implicitly preempts state law. *Id.* at 152-53, 102 *S. Ct.* at 3022, 73 *L. Ed.* 2d at 675. That Congress intended the Parity Act to have preemptive power over state laws is clear, but less clear is which laws it intended to preempt. OTS, one of the regulatory agencies responsible for enforcement of the Parity Act, was left to determine the general goals of the Act and to interpret its cryptic language.

The regulations of a federal agency are given the same weight and afforded the same presumptions regarding preemption as federal statutes unless the regulations are "arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A., Inc. v. Natural Res. Def. Council,* 467 *U.S.* 837, 844, 104 *S. Ct.* 2778, 2782, 81 *L. Ed.* 2d 694, 703 (1984). A federal regulation will have preemptive effect provided the agency intended to preempt state law and acted within the scope of its authority. *Fid. Fed., supra,* 458 *U.S.* at 154, 102 *S. Ct.* at 3023, 73 *L. Ed.* 2d at 675; *Taylor v. First Union Nat'l Bank,* 162 *N.J.* 75, 88 (1999).

A court generally must defer to a regulatory agency's decision, unless the agency acts outside the scope of its authority or arbitrarily. *Fid. Fed., supra,* 458 *U.S.* at 153-54,

102 S. Ct. at 3022-23, 73 L. Ed. 2d at 675. Deference is warranted

> because the responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones, and because of the agency's greater familiarity with the ever-changing facts and circumstances surrounding the subjects regulated.
>
> [*FDA v. Brown & Williamson Tobacco Corp.*, 529 *U.S.* 120, 132, 120 *S. Ct.* 1291, 1300, 146 *L. Ed.* 2d 121, 134 (2000) (internal quotation marks and citations omitted).]

An agency's statutory interpretation is entitled to deference even when that agency has changed its interpretation over time. "An initial agency interpretation is not instantly carved in stone. On the contrary, the agency, to engage in informed rulemaking, must consider varying interpretations and the wisdom of its policy on a continuing basis." *Chevron, supra,* 467 *U.S.* at 863-64, 104 *S. Ct.* at 2792, 81 *L. Ed.* 2d at 715-16; *see also Motor Vehicle Mfrs. Ass'n of United States v. State Farm Mut. Auto. Ins. Co.*, 463 *U.S.* 29, 42, 103 *S. Ct.* 2856, 2866, 77 *L. Ed.* 2d 443, 457 (1983) (finding that agencies "must be given ample latitude to adapt their rules to the demands of changing circumstances") (internal quotation marks and citation omitted); *Brown & Williamson Tobacco Corp., supra,* 529 *U.S.* at 156-57, 120 *S. Ct.* at 1313, 146 *L. Ed.* 2d at 149. However, when an agency changes its course, it must provide a "reasoned analysis." *Motor Vehicle Mfrs. Ass'n, supra,* 463 *U.S.* at 57, 103 *S. Ct.* at 2874, 77 *L. Ed.* 2d at 466. In those instances in which Congress has not spoken directly to the issue, but "the agency's interpretation is

reasonable," we must not reject "an agency's exercise of its generally conferred authority to resolve a particular statutory ambiguity simply because the agency's chosen resolution seems unwise." *United States v. Mead Corp.*, 533 *U.S.* 218, 229, 121 *S. Ct.* 2164, 2172, 150 *L. Ed.* 2d 292, 305 (2001).

Although due deference must be given to an agency's interpretation of a statute in an area over which it has regulatory power, "the final word on statutory interpretation is for the courts." *Grunbeck, supra,* 74 *F.*3d at 341. Therefore, we must decide whether Congress conferred on OTS the authority to preempt states' prepayment penalty laws as they apply to AMTs. There is no doubt that OTS intended its regulation to preempt states' prepayment penalty laws. *1996 Final Rule, supra,* 61 *Fed. Reg.* at 50,983. The only issue to be resolved is whether OTS was authorized pursuant to the Parity Act to apply § 560.34, which protected federally-chartered housing lenders from laws forbidding prepayment penalties, to state-chartered housing lenders by its incorporation into 12 *C.F.R.* § 560.220.

IV.

OTS currently takes the position that allowing the charging of prepayment penalties on an AMT is not intrinsic to the Parity Act's mandate. However, in 1996, construing parity to mean competitive equality between state and federal housing lenders appeared a sensible interpretation of the language of the Act and a laudable goal. The Appellate Division has concluded that the 1996 version of 12 *C.F.R.* § 560.220 was a mistaken interpretation of the Parity Act based on OTS's change of course.

Glukowsky, supra, 360 *N.J. Super.* at 31-34, 36. Regulatory law, however, is not static. It has elasticity that permits it to adapt to changing circumstances and conditions. In rejecting a challenge to the validity of rules promulgated by the Interstate Commerce Commission, the United States Supreme Court stated:

> Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy. They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.
>
> [*Am. Trucking Ass'ns, Inc. v. Atchison, Topeka & Santa Fe R. Co.,* 387 *U.S.* 397, 416, 87 *S. Ct.* 1608, 1618, 18 *L. Ed.* 2d 847, 860 (1967).]

See also In re PSE & G Co.'s Rate Unbundling, 167 *N.J.* 377, 385 (2001) (noting administrative agencies' ability to be flexible and responsive to changing conditions); *Heir v. Degnan,* 82 *N.J.* 109, 121-22 (1980) (observing advantage of administrative regulations is flexibility to keep pace with current needs). A regulatory agency is charged with the responsibility of adapting its regulations to changing conditions when enforcing a statute under its authority. *See, e.g., Bob Jones Univ. v. United States,* 461 *U.S.* 574, 596, 103 *S. Ct.* 2017, 2031, 76 *L. Ed.* 2d 157, 176 (1983) (acknowledging IRS's administrative authority "to meet changing conditions and new problems"). In addressing rapidly changing and sometimes difficult to understand market conditions, a regulatory agency may experiment – within the scope of its authority – to meet the pressing needs of the moment. "One of the most significant advantages of the administrative

process is its ability to adapt to new circumstances in a flexible manner. . . ." *FCC v. Nat'l Citizens Comm. for Broad.*, 436 *U.S.* 775, 811, 98 *S. Ct.* 2096, 2120, 56 *L. Ed.* 2d, 697, 724 (1978).

Time and experience have taught OTS that preempting states' prepayment penalty laws is not essential to the goals of the Parity Act. State-chartered housing lenders that are barred by state law from charging prepayment fees will not necessarily be less profitable. Those lenders can do what lenders have always done – adjust their interest rates to compete in the marketplace. *2002 Notice of Proposed Rulemaking, supra,* 67 *Fed. Reg.* at 20,473. Real-world experience has shown OTS that a regulation that appeared eminently reasonable in 1996 is not necessary to achieve the paramount objectives of the Parity Act in 2003. That OTS altered its direction to better effectuate the purposes of the Parity Act does not require the conclusion that its 1996 interpretation of that Act was impermissible. OTS's commentary on its 2002 rule change speaks persuasively to that point:

> In this final rule, OTS has selected between two permissible interpretations of [the Parity Act] based upon a reevaluation of the statute. OTS has, in no way, concluded that the 1996 rule changes reflected an impermissible construction of its statute. Accordingly, there is no basis for arguing that the final rule applies retroactively to transactions consummated before the effective date.
>
> [*2002 Final Rule, supra,* 67 *Fed. Reg.* at 60,550.]

Further, the Appellate Division's reliance on the *2002 Notice of Proposed Rulemaking* to the exclusion of the *Final Rule* fails to account for the preliminary nature of

proposed rulemaking. *See Dow Chem., USA v. Consumer Prod. Safety Comm'n,* 459 *F. Supp.* 378, 391 (W.D. La. 1978) (recognizing informal rulemaking process as channel for participation by public, experts, and other constituencies to provide information on effects of proposed rules and to suggest alternatives). Established principles of administrative law require that a reviewing court defer to an agency's own resolution of a conflict between that agency's decisions. *See Smith v. Brown,* 35 *F.*3d 1516, 1527 (Fed. Cir. 1994), *superseded by statute on other grounds stated by Disabled Am. Veterans v. Gober,* 234 *F.*3d 682 (Fed. Cir. 2000), *rehearing denied* (2001). The Appellate Division accorded greater weight to commentary in the Proposed Rule than to commentary in the Final Rule. *Contra Christensen v. Harris County,* 529 *U.S.* 576, 587, 120 *S. Ct.* 1655, 1662-63, 146 *L. Ed.* 2d 621, 631 (2000) (declining to accord *Chevron* deference to informal agency pronouncements); *Madison v. Res. for Human Dev. Inc.,* 233 *F.*3d 175, 185 (3d Cir. 2000) (acknowledging that informal agency interpretations are accorded less deference than regulations).

Unless there are compelling indications that OTS is wrong in concluding that there are two permissible interpretations of the Parity Act, we should exercise restraint before rushing to invalidate the 1996 regulation. *N.J. Guild of Hearing Aid Dispensers v. Long,* 75 *N.J.* 544, 575-76 (1978); *see also Matturri v. Bd. of Trs. of the Judicial Ret. Sys.,* 173 *N.J.* 368, 382 (2002).

V.

In deciding whether OTS exceeded the scope of its authority in promulgating 12 *C.F.R.* § 560.220, we give due

consideration to the interpretation of the Parity Act by the federal courts. Federal courts uniformly have concluded that the Parity Act allowed federal agencies to promulgate regulations preempting state laws governing prepayment penalties.

In *Shinn v. Encore Mortgage Services, Inc., supra,* 96 *F. Supp.* 2d at 424, 426, the district court determined that Congress had granted OTS broad authority to regulate state-chartered lenders engaged in AMTs and that the 1996 version of 12 *C.F.R.* § 560.220 preempted New Jersey's Prepayment Penalty Law, *N.J.S.A.* 46:10B-2, as applied to state-chartered lenders engaged in AMTs. *See also Glukowsky, supra,* 360 *N.J. Super.* at 31 (noting same result in unpublished decision of *Benay v. Ameriquest Mortgage Co.,* No. CIVA002173 DMC, 2001 WL 34120911, at (D.N.J. June 29, 2001)). The district court reasoned that the Parity Act did not have the limited purpose of pre-empting only those "state laws, which would completely prohibit or obstruct the creation of AMTs." *Shinn, supra,* 96 *F. Supp.* 2d at 425. The court rejected the plaintiffs' claims that "the sole purpose of the Act is to enable state lenders to engage in AMTs" and instead found that a "paramount purpose of the Act is to create parity between state and federal lenders who engage in AMTs." *Ibid.* The court concluded that the regulation reflected "a permissible interpretation of the congressional authority vested in the OTS under the Parity Act." *Ibid.*

In *National Home Equity Mortgage Ass'n v. Face, supra,* 239 *F.*3d at 639-40, the United States Court of Appeals for the Fourth Circuit also endorsed the view that Congress delegated broad authority to OTS to regulate state-chartered housing creditors that elected to have their AMTs governed by the Parity Act. *Id.* at 639. The

court found that in exercising that rulemaking authority, OTS was permitted to preempt not only those state laws that prohibited AMTs, but also those laws that denied state-chartered housing creditors competitive parity with federally-chartered lenders. *Id.* at 640. Consequently, the Court of Appeals held that 12 *C.F.R.* § 560.34 as incorporated into 12 *C.F.R.* § 560.220 preempted Virginia from enforcing against state lenders its laws limiting prepayment penalties involving AMTs. *Id.* at 635, 640.

In *McCarthy v. Option One Mortgage Corp., supra,* 362 *F.*3d at 1010-11, the Seventh Circuit Court of Appeals followed the analysis in *Face* and *Shinn* to hold that an Illinois law prohibiting prepayment penalties did not apply to an AMT paid off in 2001 under the Parity Act. Notably, *McCarthy* was decided after the rule change to 12 *C.F.R.* § 560.220 that eliminated the application of 12 *C.F.R.* § 560.34 to state-chartered lenders. The court found that the "Parity Act provides equal opportunity for state-chartered lenders to offer alternative mortgages as long as they comply with federal regulations." *Id.* at 1011. The court did not engage in a hindsight assessment of the 1996 version of 12 *C.F.R.* § 560.220 through the prism of the 2002 rule change. The court implicitly concluded that the 1996 regulation was a permissible interpretation of the Parity Act.

Last, in *National Home Equity Mortgage Ass'n v. OTS,* 271 *F. Supp.* 2d 264, 268 (D.D.C. 2003), the plaintiff challenged not the 1996 incarnation of 12 *C.F.R.* § 560.220, but whether the 2002 rule change was a valid expression of the authority delegated to OTS by Congress. In that case, the plaintiff brought suit against OTS, challenging the removal of § 560.34 from 12 *C.F.R.* § 560.220, the effect of which was to allow state prepayment penalty laws to

apply to AMTs. *Id.* at 268, 269. The district court held that the 2002 rule change by OTS was entitled to deference. *Id.* at 275. The court determined that "the text of [the Parity Act] clearly permits OTS to conclude that the Act requires it to identify only those regulations authorizing AMTs, and to define such regulations as those that are 'essential or intrinsic' to [a state-chartered lender's] ability to provide AMTs." *Id.* at 273. The district court found that the [sic] "the scope of the [Parity] Act's preemption is ambiguous," *id.* at 272, although suggestive of an intent by Congress "to preempt only those regulations authorizing AMTs," *id.* at 271. The court noted that plaintiff's reading of the statute as requiring preemption of all state laws governing AMTs was "one reasonable interpretation of the Parity Act, [although] it is not expressly required by the plain language of the Act, nor is it the only reasonable interpretation of the [the Parity Act's] terms." *Ibid.* Therefore, inferentially, OTS's 1996 adoption of 12 *C.F.R.* § 560.220 was a reasonable interpretation of the Act.

Those federal court decisions, while not binding on New Jersey courts, are entitled to respectful consideration in the interests of judicial comity. Judicial comity helps to ensure uniformity and discourage forum shopping. *Dewey, supra,* 121 *N.J.* at 80.

Finally, because OTS is the administrative agency charged with enforcement of the Parity Act, its opinion is entitled to great weight and is a substantial factor in our interpretation of the Act. *N.J. Guild, supra,* 75 *N.J.* at 575 (quoting *Youakim v. Miller,* 425 *U.S.* 231, 235, 96 *S. Ct.* 1399, 1402, 47 *L. Ed.* 2d 701, 706 (1976)). We cannot conclude, based on the language of the Parity Act or its legislative history, that Congress would not have sanctioned OTS's interpretation of the Act. *See Fid. Fed.,*

supra, 458 *U.S.* at 153-54, 102 *S. Ct.* at 3022, 73 *L. Ed.* 2d at 675 (citing *United States v. Shimer*, 367 *U.S.* 374, 381-82, 81 *S. Ct.* 1554, 1559-60, 6 *L. Ed.* 2d 908, 913-14 (1961)). Although the Appellate Division's view represents one reasonable interpretation of the authority granted to OTS under the statute, we find that it is not the only reasonable interpretation. We, therefore, cannot declare invalid OTS's decision to adopt the 1996 regulation.

VI.

This case has brought to our attention a gap in our court rules. *Rule* 4:28-4(a) requires a party challenging the validity of a State statute, rule, regulation, executive order or franchise in a legal action to give notice of the challenge to the Attorney General. *Rule* 2:5-1(h) requires that notice to the Attorney General be provided when such a challenge is raised on appeal. However, we have no comparable rule requiring that notice be given to the attorney or chief legal officer of a federal department or agency when its laws or regulations are challenged in our courts. We, therefore, submit to the Civil Rules Practice Committee consideration of an appropriate revision to our rules that will require notice to be given to the appropriate federal officer and agency when a federal law or regulation is challenged in a New Jersey court.

VII.

We hold that the New Jersey Prepayment Law was preempted by the 1996 version of 12 *C.F.R.* § 560.220. Accordingly, we reverse the decision of the Appellate Division, and reinstate the decision of the trial court

dismissing plaintiff's complaint for failure to state a claim upon which relief can be granted.[9]

CHIEF JUSTICE PORITZ and JUSTICES LONG, and LaVECCHIA join in JUSTICE ALBIN's opinion. JUSTICE ZAZZALI filed a separate dissenting opinion in which JUSTICES VERNIERO and WALLACE join.

JUSTICE ZAZZALI, dissenting.

The majority opinion represents a principled treatment of a complex problem. However, I do not believe that the preemption doctrine applies. Therefore, I respectfully dissent. I would affirm the judgment of the Appellate Division substantially for the reasons expressed by Judge King in his comprehensive and well-reasoned opinion. *Glukowsky v. Equity One, Inc.*, 360 *N.J. Super.* 1 (2003).

I write further only to underscore the point that affording lenders protection under the 1996 regulation, which by now has been universally recognized as misguided, becomes especially unjust when viewed in conjunction with the sequence of events relating to the "opt-out" mechanism provided by Congress when it enacted the underlying legislation. *Ante* at ___ at ___ (slip op. at 9).

In passing the Parity Act, Congress afforded each state three years to assert its right not to be preempted by the federal regulatory scheme. 12 *U.S.C.A.* § 3804. Congress enacted the law including that provision in 1982,

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[9] Although our dissenting colleagues observe that "plaintiff might yet find relief by alleging a violation of 12 *C.F.R.* § 591.5(b)(2)(i)," we express no view on the validity of the filing of any new complaint.

some fourteen years before the suspect 1996 regulation was promulgated. *Ante* at ___ (slip op. at 9). During the three-year window from 1982 to 1985, neither the New Jersey Legislature nor that of any other state could predict that the OTS, or any other regulatory agency, someday would turn the salutary congressional goal of ensuring the availability of alternative mortgages on its head by sanctioning what arguably amount to predatory lending practices by state-chartered institutions. As explained by Judge King, the countenance of those practices, by the federal regulators' own admission, finds no support in the intent manifested by Congress when it enacted the Parity Act. *Glukowsky, supra,* 360 *N.J. Super.* at 32-34. That such an *ultra vires* regulation came into being only after the states were no longer free to exempt themselves compounds the injustice of allowing such lending practices the safe-haven accorded by preemption in these circumstances.

Finally, by virtue of the rule that a dismissal under *Rule* 4:6-2(e) is presumptively without prejudice, *Printing Mart-Morristown v. Sharp Electronics Corp.,* 116 *N.J.* 739, 772 (1989), plaintiff might yet find relief by alleging a violation of 12 *C.F.R.* 591.5(b)(2)(i). As the Appellate Division noted, that regulation prevents lenders from collecting prepayment penalties when they have demanded full payment under a due-on-sale clause. *Glukowsky, supra,* 360 *N.J. Super.* at 23-24.

Justice Verniero and Justice Wallace join in this opinion.

SUPREME COURT OF NEW JERSEY
C-746 September Term 2003
55,729

VICTOR and ELAINE YURITCH,

Plaintiffs-Respondents,

v.

COUNTRYWIDE HOME LOANS, INC., D/B/A AMERICA'S WHOLESALE LENDER, A FOREIGN CORPORATION,

Defendant-Petitioner.

ON PETITION FOR CERTIFICATION

(Filed Jul. 12, 2004)

To the Appellate Division, Superior Court:

A petition for certification of the judgment in A-2850-02 having been submitted to this Court, and the Court having considered the same;

It is ORDERED that the petition for certification is granted, the judgment of the Appellate Division is summarily reversed, and the order of the Superior Court, Law Division, Camden County, (L-5030-02) is reinstated. See *Glukowsky v. Equity One, Inc.*, ___ *N.J.* ___ (decided May 26, 2004).

WITNESS, the Honorable Deborah T. Poritz, Chief Justice, at Trenton, this 8th day of July, 2004.

/s/ Stephen Townsend
CLERK OF THE SUPREME COURT

NOT FOR PUBLICATION WITHOUT THE APPROVAL OF THE APPELALTE DIVISION

SUEPRIOR COURT OF NEW JERSEY
APPELLATE DIVISION
DOCKET NO. A-3202-01T3

MARK GLUKOWSKY,

Plaintiff-Appellant,

v. (Filed Apr. 24, 2003)

EQUITY ONE, INC.,

Defendant-Respondent.

Submitted: February 5, 2003 Decided: APR 24, 2003

Before Judges King, Wefing and Lisa.

On appeal from the Superior Court of New Jersey, Law Division, Gloucester County, L-872-01.

Lewis G. Adler, attorney for appellant (Mr. Adler, Roger C. Mattson and Louis D. Fletcher, on the brief).

Reed Smith, attorneys for respondent (Lauren Graham, Delehey, of counsel; Leonard A. Bernstein, Robert M. Jaworski and Ms. Delehey, on the brief).

The opinion of the court was delivered by

KING, P.J.A.D.

This case presents a question of federal preemption of state law respecting prepayment fees for residential

mortgages. We find no federal preemption, reverse and remand for further proceedings.

I

In 1999, plaintiff secured a residential mortgage from defendant in the amount of $72,000. This was a so-called "balloon loan," meaning that the debt matures at the end of an interval shorter than the terms of the amortization schedule. At the maturity date, in 2009, plaintiff would still owe $62,021.25. This is considered an alternative mortgage transaction (AMT) under federal law. AMTs are all residential mortgages other than traditional, fixed-term, fixed-rate mortgages.

In 2001, plaintiff sold the mortgaged property. At that time, plaintiff prepaid the remaining loan balance plus a prepayment fee amounting to two percent of the principal balance of the loan ($1,427.97). The prepayment fee was calculated under the terms of a "Prepayment Rider" to the mortgage contract.

Plaintiff then filed suit alleging that prepayment fees, regardless of their amount, violate New Jersey law, relying upon the Prepayment Law, *N.J.S.A.* 46:10B-1 to -11.1; the Market Rate Consumer Loan Act, *N.J.S.A.* 17:3B-4 to -27; and the Consumer Fraud Act, *N.J.S.A.* 56:8-1 to -2.13. Upon defendant's motion, the Law Division judge dismissed the complaint, under *R.* 4:6-2(e), for failure to state a claim upon which relief can be granted, holding that the state law claims were preempted by federal law.

The questions presented on this appeal are: (1) whether the complaint states a claim for which relief may be granted under New Jersey law, and (2) whether any

valid state law claims nevertheless must be dismissed because they are preempted by federal law.

Plaintiff also contends that he should be permitted to amend the complaint to assert claims under: (1) a federal due-on-sale regulation, 12 *C.F.R.* § 591.5(b)(2)(i), which prohibits housing lenders from collecting prepayment fees where they have demanded prepayment of the mortgage under the mortgage contract's due-on-sale clause (A due-on-sale clause is "a contractual provision that permits the lender to declare the entire balance of a loan immediately due and payable if the property securing the loan is sold or otherwise transferred." *Fid. Fed. Sav. and Loan Ass'n v. de la Cuesta,* 458 *U.S.* 141, 145, 102 *S. Ct.* 3014, 3018, 73 *L. Ed.* 2d 664, 670 (1982)); (2) the Licensed Lenders Act, *N.J.S.A.* 17:11C-1 to -49, and one of the regulations adopted thereunder, *N.J.A.C.* 3:15-10.1, which prohibits prepayment fees; and (3) general contract law principles which prohibit unconscionable contract terms, such as the Prepayment Rider to the mortgage contract. Plaintiff does not explicitly request permission to amend the complaint to assert these claims. Instead, he argues as though these claims are pled in the complaint. Since they clearly are not, we treat plaintiff's arguments as requests for permission to amend the complaint.

As to the preemption issue, the central issue on appeal, there clearly exists a direct conflict between state and federal law regarding whether prepayment penalties may be charged in alternative mortgage transactions. New Jersey explicitly prohibits state-chartered housing creditors from collecting prepayment penalties, with respect to *any* residential mortgage transaction. *See N.J.S.A.* 46:10B-2. On the other hand, a 1996 federal regulation, issued by the Office of Thrift Supervision (OTS), permits state-chartered housing

creditors to charge prepayment fees in alternative mortgage transactions. *See* 12 *C.F.R.* § 560.220 (incorporating 12 *C.F.R.* § 560.34, which permits federally chartered housing creditors to collect prepayment penalties, and applying it to state-chartered housing creditors with respect to AMTs). The OTS adopted 12 *C.F.R.* § 560.220 pursuant to authority delegated to it by Congress, under the Alternative Mortgage Transactions Parity Act (Parity Act), 12 *U.S.C.A.* § 3801 to § 3806. Furthermore, in adopting 12 *C.F.R.* § 560.220, the OTS expressly stated that this regulation was intended to preempt state law to the contrary.

Thus, we must hold that 12 *C.F.R.* § 560.220 preempts plaintiff's state law claims challenging the prepayment fee unless we find that in issuing this regulation the OTS acted arbitrarily, or exceeded the authority delegated to it by Congress. This is the nub of the preemption issue. Plaintiff contends that 12 *C.F.R.* § 560.220 is invalid because, in issuing it, the OTS exceeded the authority delegated to it by Congress under the Parity Act. We agree.

In finding federal preemption, and dismissing the complaint, the Law Division judge primarily relied upon two published federal court decisions in which the courts held that 12 *C.F.R.* § 560.220 was a valid exercise of the OTS's delegated authority, and that 12 *C.F.R.* § 560.220 preempted state laws regulating prepayment fees – at least to the extent those state laws are applied in the context of alternative mortgage transactions. *See Nat'l Home Equity Mortgage Ass'n v. Face* (*Face*) 239 *F.*3d 633 (4th Cir.), *cert. denied,* 534 *U.S.* 823, 122 *S. Ct.* 58, 151 *L. Ed.* 2d 26 (2001); *Shinn v. Encore Mortgage Serv., Inc.,* 96 *F. Supp.* 2d 419, 422 (D.N.J. 2000).

Since the Law Division judge entered judgment, however, there has been a significant, albeit unusual, development, which casts doubt on these federal decisions and subjects them to closer scrutiny. Specifically, in April 2002, the OTS published a Notice of Proposed Rulemaking in which it repudiated 12 *C.F.R.* § 560.220 and put forth a number of arguments which support a conclusion that, in adopting 12 *C.F.R.* § 560.220 in 1996, the OTS acted arbitrarily and exceeded the authority delegated to it by Congress. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 20,468 (Apr. 25, 2002). Subsequently, the OTS adopted that Proposed Rulemaking as final. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 Fed. Reg., 60,542 (Sept. 26, 2002). We agree with the arguments advanced by the OTS and find they are supported by a recent case from the California Court of Appeals, in which that court discussed the limited nature of the Parity Act's preemption clause, although in a context different than presented in this case. *See Black v. Fin. Freedom Senior Funding Corp.,* 112 *Cal. Rptr.* 2d 445, 457 (Cal. Ct. App. 2001), *cert. denied sub nom., ULLICO, Inc. v. Black,* ___ *U.S.* ___, 122 *S. Ct.* 2662, 153 *L. Ed. 2d* 837 (2002).

We reverse the rulings of the Law Division judge, in part. We hold that plaintiff's state law claims are not preempted by 12 *C.F.R.* § 560.220 because this regulation was adopted arbitrarily, and exceeds the scope of authority Congress delegated to the OTS under the Parity Act. We remand for further proceedings on plaintiff's claims under the Prepayment Law and the Consumer Fraud Act. We affirm dismissal of plaintiff's claim under the Market Rate Consumer Loan Act because defendant is not an entity covered by this statute. Finally on remand, plaintiff

is permitted to amend the complaint to assert claims under the federal due-on-sale regulation, 12 *C.F.R.* § 591.5(e)(2)(i); *N.J.A.C.* 3:15-10.1(b) and general contract principles; defendant may raise the issue of retroactivity.

II

This is the procedural context. On May 17, 2002 plaintiff filed a complaint alleging that in collecting a prepayment fee with respect to the prepayment of his mortgage defendant violated New Jersey's Prepayment Law, *N.J.S.A.* 46:10B-2, and the Market Rate Consumer Loan Act, *N.J.S.A.* 17:3B-22. Plaintiff also alleged that collection of a prepayment fee constituted an unconscionable business practice, in violation of the Consumer Fraud Act, *N.J.S.A.* 56:8-2. Plaintiff also sought class certification.

In lieu of an answer, defendant filed a motion to dismiss, under *R.* 4:6-2, for failure to state a claim upon which relief may be granted. Plaintiff opposed that motion, and filed a cross-motion for summary judgment, which defendants opposed. After hearing oral argument on January 18, 2002 the judge issued an oral decision, granting defendant's motion, and denying plaintiff's cross-motion.

III

Defendant is a Delaware corporation, which maintains an office in Mount Laurel, Burlington County. Defendant is licensed under New Jersey's Licensed Lenders Act and engages in the business of residential mortgage lending.

On October 29, 1999 plaintiff and a co-borrower financed the purchase of a residence, located at 133-135 Route 530 (Pemberton Road), Southampton, Burlington County, with a mortgage loan secured from defendant. The total amount of the mortgage was $72,000, and the maturity date was November 1, 2009. The mortgage contract provided for federal and New Jersey law to control the transaction.

The mortgage is considered a "balloon loan." At maturity, plaintiff would still owe $62,021.25 of the principal and would be obligated to repay that entire amount, or obtain refinancing from defendant or another mortgage lender. Under the terms of the mortgage, defendant reserved the right not to refinance the loan.

Of particular relevance to this case is the Prepayment Rider to the mortgage's "Balloon Note." The Prepayment Rider imposes a prepayment fee if the mortgage is prepaid in full during the first three years of the loan term. Specifically, the Prepayment Rider states:

> 4. **BORROWER'S RIGHT TO REPAY**
>
> I have the right to make payments of principal at any time before they are due. A payment of principal only is known as a "prepayment." When I make a prepayment, I will tell the Note Holder in writing that I am doing so.
>
> I may make a partial prepayment without paying the prepayment charge. *If I make a full prepayment within one (1) year of the date of this Note, I agree to pay a prepayment charge of 3.0000% of the amount being prepaid; If I make a full prepayment more than one (1) year but within two (2) years of the date of this Note, I agree to pay a prepayment charge of 2.0000% of the amount being*

> *prepaid; if I make a full prepayment more than two (2) years but within three (3) years of the date of this Note, I agree to pay a prepayment charge of 1.0000% of the amount being prepaid. If I make full prepayment more than three (3) years after the date of this Note, there will be no prepayment charge.* The Note Holder will use all of my prepayments to reduce the amount of principal that I owe under this Note. If I make a partial prepayment, there will be no changes in the due date or in the amount of my monthly payment unless the Note Holder agrees in writing to those changes. My partial prepayment may reduce the amount of my monthly payments after the first Change Date following my partial prepayment. However, any reduction due to my partial prepayment may be offset by an interest rate increase.
>
> [(emphasis added).]

The Prepayment Rider amended language in the "Balloon Note," under which no prepayment penalties could be imposed.

Also relevant is Section 17 of the mortgage contract, the so-called due-on-sale clause, which states, in pertinent part, as follows:

> 17. **Transfer of the Property or a Beneficial Interest in Borrower.** If all or any part of the Property or any interest in it is sold or transferred . . . without Lender's prior written consent, Lender may, at its option, require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if exercise is prohibited by federal law as of the date of this Security Instrument.

> If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is delivered or mailed within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.

On or about April 11, 2001 defendant provided a payoff statement to plaintiff, stating that the mortgage was in default and if not brought current, could be referred to an attorney for foreclosure. The Payoff Statement reflected the amount needed to prepay the mortgage in full, which included the remaining principal balance, interest, various fees and late charges, plus a prepayment fee of $1,427.97. Plaintiff sold the property, and on April 19, 2001 paid the amount indicated in the Payoff Statement, including the prepayment fee.

SUMMARY OF APPLICABLE LAW

This case involves a spider's web of federal and state statutes and regulations governing mortgage transactions. To complicate things, the parties dispute which statutes and regulations actually apply in the context of this case.

We provide summaries of the statutes and regulations at issue in this case. We also summarily resolve some of the parties' more specious arguments, regarding the applicability of the various statutes and regulations, in our attempt to narrow the issues presented.

State Statutes and Regulations

The complaint alleges violations of three New Jersey statutes: (1) the Prepayment Law; (2) the Market Rate Consumer Loan Act; and (3) the Consumer Fraud Act. On appeal, plaintiff also essentially requests permission to amend the complaint, to assert a claim under the New Jersey Licensed Lenders Act, *N.J.S.A.* 17:11C-1 to -49, and *N.J.A.C.* 3:15-10.1, a regulation adopted under *N.J.S.A.* 17:11C-49.

The Prepayment Law

New Jersey's Prepayment Law provides that "[p]repayment of a mortgage loan may be made by or on behalf of a mortgagor at any time without penalty." *N.J.S.A.* 46:10B-2. The statute defines "prepayment" as "payment in full of the balance owing on a mortgage loan at any time prior to the time limited for the final payment of such loan in an instrument evidencing such loan." *N.J.S.A.* 46:10B-1(c).

The Prepayment Law also provides for a limited right to make partial prepayments of mortgage principal, without incurring a prepayment fee. Specifically, *N.J.S.A.* 46:10B-3 provides as follows:

> A mortgagor shall have the right, during any 6 month period beginning with the date of the mortgage loan, to pay, without charge or penalty, an additional sum of $50.00, or multiples thereof, on account of the principal amount owing on a mortgage loan, provided that the additional sums so paid and the principal payments required to be made by the terms of such mortgage loan during such 6 month period do not together exceed in any such 6 month period 33-1/3% of the face

> amount of such mortgage loan. The right to make additional payments as provided by this section shall not be cumulative, and to the extent that it is not exercised during any 6 month period, shall lapse.

In addition, the Prepayment Law provides that no provision of a mortgage which denies the rights conferred by the above sections [*N.J.S.A.* 46:10B-2 and *N.J.S.A.* 46:10B-3] shall be enforceable, *N.J.S.A.* 46:10B-4, and that any prepayment fees collected in knowing violation of the statute must be repaid, with interest calculated at six percent per annum. *N.J.S.A.* 46:10B-5.

Finally, the Prepayment Law provides that:

> This act shall not apply to loans secured by a mortgage on real property the prepayment of which is governed by any other statute of this State or of the United States, nor shall it apply to any loans, secured by mortgage on real property, made pursuant to any statute of this State or of the United States expressly authorizing interest charges in excess of 6% per annum.
>
> [*N.J.S.A.* 46:10B-9.]

The Market Rate Consumer Loan Act

As its name implies, the Market Rate Consumer Loan Act regulates consumer loan transactions. *N.J.S.A.* 17:3B-4 to -27. It applies to loans offered by "lenders," with "lenders" defined as: (1) "banking institutions" (defined as banks, out-of-state or out-of-country banks having a branch office in New Jersey, savings banks, and national banking associations having a principal or a branch office in New Jersey); (2) federally chartered savings banks; and

(3) "associations" (defined as state associations, federal associations having a principal or a branch office in New Jersey, and out-of-state associations having a branch office in New Jersey). *N.J.S.A.* 17:3B-5(d); *N.J.S.A.* 17:9A-1(2); *N.J.S.A.* 17:12B-5(3).

The Market Rate Consumer Loan Act prohibits lenders, as defined above, from charging prepayment fees, as follows:

> a. An individual borrower may prepay a loan in full at any time without payment of any prepayment charge.
>
> b. If a borrower wishes to prepay a loan, a lender shall not use the "rule of 78's" to calculate the amount of interest owed by the borrower. The lender shall use a simple interest basis to calculate the amount of interest owed by the borrower.
>
> [*N.J.S.A.* 17:3B-22.]

Consumer Fraud Act

The Consumer Fraud Act prohibits "unconscionable commercial practices." *N.J.S.A.* 56:8-2. It also provides for a private right of action, to recover monies lost as a result of such practices, *N.J.S.A.* 56:8-2.12, and states that the rights protected under the Act are cumulative of other rights and remedies under New Jersey law. *N.J.S.A.* 56:8-2.13.

New Jersey Licensed Lenders Act

Defendant is licensed as, among other things, a "mortgage banker," under the New Jersey Licensed Lenders Act (Licensed Lenders Act). *N.J.S.A.* 17:11C-1 to -49. A

regulation adopted, in part, under the Licensed Lenders Act, *N.J.S.A.* 17:11C-49, provides that: "[a] borrower may repay a first mortgage loan, second mortgage loan or consumer loan at any time without penalty." *N.J.A.C.* 3:15-10.1(b). *See also N.J.A.C.*, Title 3, Ch. 15, References and Annotations.

Federal Statutes and Regulations The Parity Act

The only federal law of significance to this litigation is: (1) the Parity Act, 12 *U.S.C.A.* § 3801 to § 3806, which was adopted in 1982; and (2) a regulation adopted by the OTS, under the Parity Act, in 1996, 12 *C.F.R.* § 560.220. It is 12 *C.F.R.* § 560.220 which allegedly preempts plaintiff's state law claims.

Purpose of the Parity Act

Prior to passage of the Parity Act, federal regulations permitted federally chartered housing lenders to engage in AMTs. Many states, however, prohibited state-chartered housing lenders (also referred to as "non-federally chartered housing lenders") from engaging in AMTs. *Shinn,* 96 *F. Supp.* at 422.

The purpose of the Parity Act was to provide parity between federally chartered and state-chartered housing lenders, *"by authorizing all housing creditors to make, purchase and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued"* by the relevant federal agencies. 12 *U.S.C.A.* § 3801(b) (emphasis added). The relevant federal agencies, issuing regulations under the Parity Act, are: (1) the Comptroller of the Currency, which issues regulations applicable to

national banks; (2) the National Credit Union Administration, which issues regulations applicable to national credit unions; and (3) the OTS, which issues regulations applicable to all other housing creditors, for example, savings and loan associations, mutual savings banks, and savings banks. 12 *U.S.C.A.* § 3801(a)(3), § 3803(a). *Shinn,* 96 *F. Supp.* 2d at 422-23. (As originally worded, the Parity Act referenced the "Federal Home Loan Bank Board," (FHLBB), which is the predecessor to the OTS). *Glass v. United States,* 258 *F.*3d 1349, 1352, n.3, *as amended by,* 273 *F.*3d 1072 (Fed. Cir. 2001); *Turner v. First Union Nat'l Bank,* 162 *N.J.* 75, 87, n.2 (1999).

Congress passed the Parity Act in 1982 in response to "increasingly volatile and dynamic changes in interest rates," which Congress found "seriously impaired the ability of housing creditors to provide consumers" with traditional residential mortgages. 12 *U.S.C.A.* § 3801(a)(1). The Act represented the congressional response to a concern that state bans on AMTs "would reduce the overall availability of mortgage credit, since fixed-rate mortgages had become relatively more expensive as the result of increased interest-rate volatility." *Grunbeck v. Dime Sav. Bank of New York, FSB,* 74 *F.*3d 331, 343 (1st Cir. 1996). Congress believed that AMTs were "essential to the provision of an adequate supply of credit secured by residential property necessary to meet the demand expected during the 1980's." 12 *U.S.C.A.* § 3801(a)(2).

Definitional Provisions

The Parity Act defines AMTs as follows:

> (1) the term "alternative mortgage transaction" means a loan or credit sale secured by an interest in residential real property, a dwelling, all

> stock allocated to a dwelling unit in a residential cooperative housing corporation, or a residential manufactured home . . .
>
> > (A) in which the interest rate or finance charge may be adjusted or renegotiated;
> >
> > (B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or
> >
> > (C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation;
>
> [12 *U.S.C.A.* § 3802(1).]

The term AMT "is a broad catch-all term for all manner of mortgage instruments that do not conform to the traditional fully-amortized, fixed-interest-rate mortgage loan." *First Gibraltar Bank, FSB v. Morales,* 19 *F.*3d 1032, 1037 (5th Cir.), *cert. denied,* 513 *U.S.* 876, 115 *S. Ct.* 204, 130 *L. Ed.*2d 134 (1994), *vacated on other grounds,* 42 *F.*3d 895 (5th Cir. 1995).

Although plaintiff disputes this fact, it is clear that the mortgage at issue in the present case qualifies as an AMT under 12 *U.S.C.A.* § 3802(1)(B) or (C). Specifically, although it is a fixed-rate, fixed-term mortgage, the debt matures at the end of an interval shorter than the term of the amortization schedule, thereby implicitly permitting rate adjustments under 12 *U.S.C.A.* § 3802(1)(B).

The mortgage also constitutes a balloon loan, which is not the traditional, fixed-rate, fixed-term mortgage. 12 *U.S.C.A.* § 3802(1)(C). Plaintiff's contention that the mortgage at issue is not a balloon note is incorrect. *Black's Law Dictionary* (6th ed. 1991) defines "balloon note" as "[a] form of promissory note which commonly calls for minimum payments of principal, if any, and the payment of interest at regular intervals, but which requires a substantial payment of principal at the end of the term; the final payment frequently representing all the principal." The mortgage at issue clearly fits this definition.

There is also no real dispute that defendant is a "housing creditor," as defined by the Parity Act, 12 *U.S.C.A.* § 3802(2), since defendant is engaged in the business of making residential mortgage loans, 12 *U.S.C.A.* § 3802(2)(C), and is licensed under New Jersey law to enter into AMTs, 12 *U.S.C.A.* § 3802(2). While plaintiff disputes that defendant is a "Licensed Lender," under New Jersey law, defendant has provided copies of its state-issued licenses to substantiate this fact.

Substantive Provisions of the Parity Act

Substantively, the Parity Act provides that all housing creditors (both federally chartered and non-federally chartered) may make, purchase, and enforce AMTs, so long as the transactions are made in accordance with regulations governing AMTs, as issued by the relevant federal agencies – the Comptroller of the Currency, the National Credit Union Administration Board, and the OTS. 12 *U.S.C.A.* § 3803(a).

The Parity Act also contains an express provision relating to the preemption of state law, which states as follows:

> An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.
>
> [12 *U.S.C.A.* § 3803(c).]

The statute further provided for a limited time-frame, after the effective date of the Parity Act, during which states could choose to opt out of the Parity Act. In order to opt out, during that limited time-frame, states were required to pass a law stating "explicitly and by its terms that such State does not want the preemption provided in [12 *U.S.C.A.* § 3803] to apply with respect to alternative mortgage transactions (or to any class or type of alternative mortgage transaction) subject to the laws of such State . . . " 12 *U.S.C.A.* § 3804(a).

New Jersey did not opt out of the Parity Act. This fact has been acknowledged by the Office of the Attorney General of the State of New Jersey, in an extensive formal opinion of March 6, 1987, and was recognized in *Shinn*, 96 *F. Supp.* 2d at 424. Plaintiff also admits this in his brief. Plaintiff's relatively brief argument, claiming that New Jersey *did* opt out of the Parity Act, is specious and is rejected. We also note that the statute plaintiff identifies as New Jersey's official "opt-out" of the Parity Act, the Market Rate Consumer Loan Act, does not explicitly state that New Jersey was opting out of Parity Act preemption. Indeed, the statute contains no reference whatsoever to the Parity Act. *N.J.S.A.* 17:3B-4 to -27. Therefore, it does

not constitute an "opt-out" of Parity Act preemption, as defined by 12 *U.S.C.A.* § 3804(a).

Relevant Federal Regulations Adopted Pursuant to the Parity Act

The parties do not dispute that, under the Parity Act, the relevant federal agency in the present case is the OTS. In 1996, the OTS adopted a regulation which clarified that state-chartered housing creditors, like their federal counterparts, are authorized to charge prepayment penalties. Specifically, in 12 *C.F.R.* § 560.220, the OTS determined that, as an exercise of its delegated powers under the Parity Act, 12 *U.S.C.A.* § 3803(a)(3), and thus in preemption of all contrary state law under 12 *U.S.C.A.* § 3803(c), the provisions of 12 *C.F.R.* § 560.34 should be applied to AMTs issued by state-chartered housing creditors. The OTS adopted 12 *C.F.R.* § 560.34 pursuant to the authority delegated to it under the Home Owners' Loan Act (HOLA), 12 *U.S.C.A.* § 1461 to § 1470. *See* 12 *C.F.R.* § 560.1(a). 12 *C.F.R.* § 560.34 provides as follows:

> Any prepayment on a real estate loan must be applied directly to reduce the principal balance on the loan unless the loan contract or the borrower specifies otherwise. *Subject to the terms of the loan contract, a Federal savings and loan association may impose a fee for any prepayment of a loan.*
>
> [(emphasis added).]

The Depository Institutions Deregulation and Monetary Control Act

Plaintiff also claims that the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA) is relevant to this case. DIDA was passed in response to congressional concern that state interest-rate ceilings were depressing home mortgage interest rates to below-market levels, thereby artificially disrupting the availability of funds for both traditional fixed-rate mortgages and AMTs. *Grunbeck,* 74 *F.*3d at 343-44. Defendant claims DIDA is irrelevant to this case.

In fact, no aspect of DIDA is directly implicated by this case. DIDA may be considered relevant only to the extent its preemption clause may be compared and contrasted to that of the Parity Act's. DIDA's preemption clause states as follows:

> (a) The provisions of the constitution of any State expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved by lenders and the provisions of any State law expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, or advance which is insured under title I or II of this chapter.
>
> (b) The provisions of subsection (a) shall apply to loans, mortgages, or advances made or executed in any State until the effective date (after December 21, 1979) of a provision of law of that State limiting the rate or amount of interest, discount points, or other charges on any such loan, mortgage, or advance.
>
> [12 *U.S.C.A.* § 1735f-7.]

DIDA's preemption provision is different from the Parity Act's in one significant respect. Clearly, DIDA's preemption provision was *not* intended to prevent state limitations on prepayment charges. *Grunbeck,* 74 *F.*3d at 340 (citing 1980 *U.S.C.C.A.N.* at 255). This fact is confirmed in the applicable federal regulation, which provides that nothing in DIDA "preempts limitations in state laws on prepayment charges, attorneys' fees, late charges or other provisions designed to protect borrowers." 12 *C.F.R.* § 590.3(c).

Plaintiff's additional contention, that DIDA is relevant to the Parity Act, because the two statutes overlap, is technically accurate. However, that statutory overlap is of no significance. Specifically, the Parity Act provides that Section 501(c)(1) of DIDA, 12 *U.S.C.A.* § 1735f-7a(c)(1), shall not apply to transactions subject to the Parity Act. 12 *U.S.C.A.* § 3805. Roughly, Section 501(c)(1) of DIDA provides that DIDA preemption shall *not* apply to a mortgage which is secured by a first lien on a manufactured residential home, unless the terms and conditions of that mortgage comply with the consumer protection provisions specified in regulations prescribed by the Federal Home Loan Bank Board (FHLBB), regarding, for example, balloon payments, prepayment penalties, late charges and deferral fees. 12 *U.S.C.A.* § 1735f-7a(c).

Thus, all the Parity Act intended, by stating that Section 501(c)(1) of DIDA does not apply to transactions subject to the Parity Act, is that "certain federal consumer protection provisions with respect to balloon payments, prepayment penalties, late charges and deferral fees that are applicable in connection with mobile home transactions are not applicable to transactions authorized by the [Parity] Act." Alan S. Kaplinsky, "Federal Usury Law

Developments," *Practicing Law Institute, Commercial Law and Practice Course Handbook Series, Consumer Financial Services Litigation* (1998).

Neither party in the present case contends that the mortgage transaction involved a mobile home. Therefore, neither 501(c)(1) of DIDA nor 12 *U.S.C.A.* § 3805 are implicated.

Federal "Due-on-Sale" Regulation

Finally, plaintiff requests permission to amend the complaint, to state a claim under the federal due-on-sale regulation. 12 *C.F.R.* § 591.5(b)(2)(i). Pursuant to authority granted under HOLA and DIDA, the OTS has issued regulations, permanently preempting state prohibitions on the exercise of due-on-sale clauses by all lenders, whether federally or state-chartered. 12 *C.F.R.* § 591.1 to 591.6. These regulations apply to all real property loans and all lenders making such loans. 12 *C.F.R.* § 591.1.

Under these regulations, specifically 12 *C.F.R.* § 591.5(b)(2)(i), no prepayment fee may be imposed where a residential mortgage lender declares, by written notice, that it is exercising a due-on-sale clause in the mortgage instrument.

IV

During oral argument on the parties' cross-motions, the Law Division judge did not engage in any analysis of plaintiff's state law claims to determine whether they stated a cause of action. Instead, the judge presumed the validity of the state law claims and turned to the federal preemption analysis, dismissing the complaint on that

basis. This is the analytical framework defendant urges on appeal.

Although it may seem unusual to consider the question of federal preemption, before determining whether plaintiff states a valid state law claim, this is the procedure we follow here. The issue of preemption is the most important one presented in this case. We conclude that the state law claims are not preempted because, in adopting 12 *C.F.R.* § 560.220, the OTS acted arbitrarily, and exceeded the authority delegated by Congress under the Parity Act.

Federal Preemption

In General

The question of federal preemption is a question of law, subject to de novo review. *New Jersey Payphone Ass'n, Inc. v. Town of West New York,* 299 *F.*3d 235, 242 (3d Cir. 2002). Congress's power to preempt state law is derived from the Supremacy Clause of the United States Constitution. *U.S. Const.* art. VI, cl. 2; *Fidelity,* 458 *U.S.* at 152, 102 *S. Ct.* at 3022, 73 *L. Ed.*2d at 674; *Abdullah v. Am. Airlines, Inc.,* 181 *F.*3d 363, 366 (3d Cir. 1999); *Turner,* 162 *N.J.* at 87. Congress may choose to occupy a field, taking all regulatory authority over a certain subject matter. Alternatively, it may share the field with the states, or adopt as federal policy the state scheme of regulation. The ultimate question in each case is one of congressional intent. *Rice v. Santa Fe Elevator Corp.,* 331 *U.S.* 218, 230, 67 *S. Ct.* 1146, 1152, 91 *L.Ed.* 1447, 1459 (1947); *Abdullah,* 181 *F.*3d at 366. The presumption, however, is that Congress did not intend to supplant state law. *Maryland v.*

Louisiana, 451 *U.S.* 725, 746, 101 *S. Ct.* 2114, 2129, 68 *L. Ed. 2d* 576, 595 (1981); *Abdullah,* 181 *F.*3d at 366.

In determining whether Congress intended to preempt state law, the starting point is the statutory language. "Preemption may be either express or implied, and 'is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose.'" *Fidelity,* 458 *U.S.* at 152-53, 102 *S. Ct.* at 3022, 73 *L. Ed. 2d* at 675 (quoting *Jones v. Rath Packing Co.,* 430 *U.S.* 519, 525, 97 *S. Ct.* 1305, 1309, 51 *L. Ed. 2d* 604, 614 (1977)).

> Absent explicit preemptive language, Congress' intent to supersede state law altogether may be inferred because "[t]he scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it," because "the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject," or because "the object sought to be obtained by federal law and the character of obligations imposed by it may reveal the same purpose."
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> [*Id.,* 458 *U.S.* at 153, 102 *S. Ct.* at 3022, 73 *L. Ed. 2d* at 675 (quoting *Rice,* 331 *U.S.* at 230, 67 *S. Ct.* at 1152, 91 *L. Ed.* at 1459).]

Accord, Turner, 162 *N.J.* at 87-88.

Even where Congress has not completely displaced state regulation in a particular subject matter, state law will be nullified to the extent it actually conflicts with federal law, i.e., to the extent compliance with both federal and state law is a physical impossibility, or to the extent state

law is an obstacle to the accomplishment of Congressional objectives. *Fidelity,* 458 *U.S.* at 153, 102 *S. Ct.* at 3022, 73 *L. Ed. 2d* at 675.

Preemptive Effect of Federal Regulations

Federal regulations "are given controlling weight *unless they are arbitrary, capricious, or manifestly contrary to the statute.*" *Chevron U.S.A., Inc. v. Natural Res. Def. Council,* 467 *U.S.* 837, 844, 104 *S. Ct.* 2778, 2782, 81 *L. Ed. 2d* 694, 703 (1984) (emphasis added). Subject to this qualification, federal regulations have the same preemptive effect as federal statutes:

> Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. *United States v. Shimer,* 367 *U.S.* 374, 381-82, 81 *S. Ct.* 1554, 1559-60, 6 *L. Ed. 2d* 908, 913-14 (1961). When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited:
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> > "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." *Id.,* 367 *U.S.* at 383, 81 *S. Ct.* at 1560, 6 *L. Ed. 2d* at 915.
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> [*Fidelity,* 458 *U.S.* at 154, 102 *S. Ct.* at 3023, 73 *L. Ed. 2d* at 675.]

Accord, Leary v. United States, 395 *U.S.* 6, 23-24, 89 *S. Ct.* 1532, 1541-42, 23 *L. Ed. 2d* 57, 74 (1969); *Brown & Williamson Tobacco Corp. v. Food and Drug Admin.,* 153 *F.*3d 155, 161 (4th Cir. 1998), *aff'd,* 529 *U.S.* 120, 120 *S. Ct.* 1291, 146 *L. Ed. 2d* 121 (2000); *Ayers v. Philadelphia Hous. Auth.,* 908 *F.*2d 1184, 1189 (3d Cir. 1990), *cert. denied,* 498 *U.S.* 1103, 111 *S. Ct.* 1003, 112 *L. Ed. 2d* 1086 (1991); *Natural Res. Def. Council v. U.S. E.P.A.,* 822 *F.*2d 104, 111-12 (D.C. Cir. 1987). *See also Turner,* 162 *N.J.* at 88 (as long as federal agency intended to preempt state law, and acted within scope of delegated authority, federal regulations have same preemptive effect as federal statutes).

Preemption and Plaintiff's State Claims
Relevant Statutory and Regulatory Language

In this case, there is no question that, through the Parity Act, Congress intended to preempt state law. The Parity Act contains an express preemption clause, which states as follows:

> An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.
>
> [12 *U.S.C.A.* § 3803(c).]

The question presented by this case is: to what extent did Congress, through the Parity Act, intend to preempt state laws? This question involves an interpretation of the scope of the Parity Act's preemption clause. *Cipollone v. Liggett Group, Inc.,* 505 *U.S.* 504, 517, 112 *S. Ct.* 2608, 2618, 120 *L. Ed. 2d* 407, 423 (1992).

Similarly, there is no question that, in passing 12 *C.F.R.* § 560.220, the OTS intended to preempt state law, pursuant to the authority delegated to the agency, by Congress, under the Parity Act. That is evident from the language of 12 *C.F.R.* § 560.220 in which the OTS stated that non-federally chartered housing creditors could make AMTs, in accordance with this regulation, "notwithstanding any state constitution, law, or regulation."

Moreover, there is no question that 12 *C.F.R.* § 560.220 actually conflicts with New Jersey law. Specifically, New Jersey's Prepayment Law expressly prohibits prepayment penalties on residential mortgages. *N.J.S.A.* 46:10B-2. However, in 12 *C.F.R.* § 560.220, the OTS determined that state-chartered housing creditors, like their federal counterparts, are authorized to charge prepayment penalties on AMTs. Specifically, in 12 *C.F.R.* § 560.220, the OTS determined that 12 *C.F.R.* § 560.34 should be applied to AMTs issued by state-chartered housing creditors, under the Parity Act. 12 *C.F.R.* § 560.34 provides that "subject to the terms of the loan contract, a Federal savings and loan association may impose a fee for any prepayment of a loan."

Thus, in the present case, the heart of the preemption issue is whether 12 *C.F.R.* § 560.220 constitutes a valid exercise of the OTS's regulatory authority. In other words, in implementing 12 *C.F.R.* § 560.220, in 1996, did the OTS exceed the bounds of authority, delegated to it by Congress, under the Parity Act? *Turner,* 162 *N.J.* at 88. *See also, Thomas v. North Carolina Dept. of Human Res.,* 478 *S.E.*2d 816, 823-24 (N.C. Ct. App. 1996) (under federal system, states possess sovereignty concurrent with that of federal government, subject only to limitations imposed by Supremacy Clause; therefore, state court had jurisdiction

to interpret federal statute and invalidate federal regulation which conflicted with it), *aff'd,* 485 *S.E.*2d 295 (N.C. 1997).

Applicable Law

There are three cases addressing the scope of the Parity Act's preemption clause, in the context of state statutes limiting prepayment penalties. They are: (1) *Shinn,* 96 *F. Supp. 2d* 419; (2) *Face,* 239 *F.*3d 633; and (3) *Benay v. Ameriquest Mortgage Co.,* No. 00-2173 (D.N.J. June 29, 2001). *Benay* is an unpublished decision, and thus has no precedential value. *R.* 1:36-3. We mention *Benay* for historical purposes and the sake of completeness, not as precedent. Both parties discussed *Benay* in their briefs. *Falcon v. American Cyanamid,* 221 *N.J. Super.* 252, 261 n.2 (App. Div.1 987).

Also relevant are a Notice of Proposed Rulemaking, published by the OTS on April 25, 2002, *Alternative Mortgage Transaction Act Parity Act; Preemption,* 67 *Fed. Reg.* 20,468 (Apr. 25, 2002), and a Final Rulemaking, published by the OTS on September 26, 2002, *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 60,542 (Sept. 26, 2002).

Shinn, 96 F. Supp. 2d 419 (D.N.J. 2000)

In *Shinn,* the plaintiffs were charged a prepayment fee of $4,838.80 when they refinanced their mortgage, which constituted an AMT under the Parity Act. *Id.* at 420, 425-26. They filed suit, alleging that the prepayment fee violated New Jersey's Prepayment Law and Consumer Fraud Act, and the Federal Truth in Lending Act. *Id.* at

420. After removing the case to federal court, the defendants moved to dismiss the state law claims, on the grounds that they were preempted by the Parity Act. *Ibid.*

The court held that the plaintiffs' claim under New Jersey's Prepayment Law was preempted by 12 *C.F.R.* § 560.220, which expressly permits state-chartered housing creditors, like their federal counterparts, to charge prepayment fees on AMTs covered by the Parity Act. *Id.* at 422-26. In reaching this conclusion, the court first determined that, in passing 12 *C.F.R.* § 560.220, the OTS "clearly expressed its intent to preempt state laws which limit state creditors' ability to charge prepayment penalties in connection with AMTs." *Id.* at 423. For this proposition, the court also relied upon an opinion letter issued by the OTS in 1996 (*OTS 1996 Opinion Letter*). In the *OTS 1996 Opinion Letter,* the OTS expressed that the Parity Act preempted a Wisconsin statute which, depending upon the circumstances, limited or flatly prohibited prepayment penalties. The OTS concluded that a contrary interpretation "would undermine the purposes of the Parity Act[,] as state housing creditors 'would be clearly disadvantaged vis-a-vis federal thrifts – the very result Congress intended to prevent.'" *Ibid.* (quoting *Effect of Parity Act on Wisconsin Prepayment Penalty Statute,* 1996 OTS LEXIS 19, *7).

Next, the *Shinn* court considered whether 12 *C.F.R.* § 560.220 constituted a valid exercise of the OTS's delegated authority under the Parity Act. As to this issue, the court concluded that, under the Parity Act, 12 *U.S.C.A.* § 3803(a)(3), Congress delegated to the Director of the OTS broad authority to regulate state-chartered housing creditors which engaged in AMTs, co-extensive with the OTS's authority to regulate comparable, federally-chartered

housing creditors. *Id.* at 424. The court thus held that the OTS had the requisite authority to issue the regulation in issue, 12 *C.F.R.* § 560.220, as well as the *OTS 1996 Opinion Letter*. *Id.* at 423-24.

The court rejected the plaintiffs' argument that the OTS's authority to issue regulations under the Parity Act, applicable to AMTs issued by state-chartered housing creditors, was limited to a sixty-day period immediately following passage of the Parity Act. The court found no support for that argument in the statutory language of the Parity Act, or in logic. *Id.* at 424-25. The court further rejected the plaintiffs' argument that, by passing 12 *C.F.R.* § 560.220 in 1996, after the Parity Act's opt-out period had ended, under 12 *U.S.C.A.* § 3804, New Jersey had been "sandbagged" into accepting the Parity Act, without understanding its true effects. *Id.* at 424-25. The court concluded that, in agreeing to the Parity Act's preemption provision, New Jersey accepted and understood that, not only would state-chartered housing creditors be governed by the OTS's regulations applicable to AMTs, but also that the OTS would have the power to issue regulations to the extent authorized by its rulemaking authority. *Id.* at 425.

Finally, the court rejected the plaintiffs' contention that 12 *C.F.R.* § 560.220 constituted an unreasonable application or interpretation of the Parity Act's preemption provision, stating:

> Contrary to plaintiffs' characterization of the [Parity] Act, the Court finds that [12 *U.S.C.A.*] § 3803(c) does not limit the preemptive effect of the [Parity] Act to state laws which would completely prohibit or obstruct the creation of AMTs. Section 3803(c) states only that "[a]n alternative mortgage transaction may be made by a housing

> creditor in accordance with this section, notwithstanding any State constitution, law, or regulation." The language of this section does not support plaintiffs' narrow interpretation of [the Parity Act's] preemptive effect. Nor does the Court agree that the sole purpose of the [Parity] Act is to enable state lenders to engage in AMTs. A paramount purpose of the [Parity] Act is [to] create parity between state and federal lenders who engage in AMTs. The Court finds that the [*OTS 1996 Opinion Letter*] and the OTS's regulations governing prepayment penalties [12 *C.F.R.* § 560.220] are, to the extent they preempt state law, a permissible interpretation of the congressional authority vested in the OTS under the Parity Act.
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> [*Id.* at 425.]

Face, 239 F.3d 633 (4th Cir. 2001)

In *Face,* the National Home Equity Mortgage Association filed a declaratory judgment suit, seeking to prohibit Virginia officials, with respect to AMTs made under the Parity Act, from enforcing a state statute which limited prepayment penalties. *Face,* 239 *F.*3d at 635-36, 638. The court held that the Virginia statute was preempted by 12 *C.F.R.* § 560.220, adopted by the OTS pursuant to authority delegated to it under the Parity Act, which expressly permits both federally and non-federally chartered housing creditors to charge prepayment penalties on AMTs, subject only to the terms of the mortgage contract. *Id.* at 638-40.

***Benay*, No. 00-2173 (D.N.J. June 29, 2001)**

In *Benay,* the plaintiffs engaged in an adjustable rate mortgage (an AMT) with defendant. When they sold the mortgaged property, they were charged a prepayment penalty of $11,045.36 on a principal balance of $249,194.24. Plaintiffs sued, alleging that the prepayment penalty violated New Jersey's Prepayment Law. Relying upon *Shinn,* 96 *F. Supp. 2d* 419, and *Face,* 239 *F.*3d 633, the court held that the Prepayment Law claim was preempted by 12 *C.F.R.* § 560.220, under which defendant was authorized to charge the prepayment penalty.

The court also considered the "reasonableness" of the amount of the prepayment fee. The court found that there was no reasonableness limitation on prepayment penalties, under either federal or state law. Rather, New Jersey courts would only void contract provisions they found to be "unconscionable." As to this issue, the court held that the prepayment penalty at issue was "neither unconscionable nor made to mislead the Plaintiffs."[1]

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[1] On October 21, 2002 the Seventh Circuit Court of Appeals issued an opinion in which it examined the breadth of federal preemption under the Alternative Mortgage Transaction Parity Act (Parity Act). *Illinois Ass'n of Mortgage Brokers v. Office of Banks and Real Estate,* 308 *F.*3d 762 (7th Cir. 2002). The court took a broad view of the intent of Congress in passing the Parity Act, and a broad view of the Parity Act's preemption clause.

The Seventh Circuit did not address preemption of prepayment penalties, in particular, which is the subject matter of our case. The court declined to address which state regulations, in particular, were preempted by the Parity Act, 12 *U.S.C.A.* § 3803(c), and applicable OTS regulations, and left that decision to the district court, on remand. *Id.* at 768.

OTS's April 25, 2002 Notice of Proposed Rulemaking

After *Shinn, Face*, and *Benay* were decided, the OTS published a Notice of Proposed Rulemaking which casts strong doubt on the correctness of the holdings in those cases. Specifically, on April 25, 2002, the OTS issued a Notice of Proposed Rulemaking in which it proposed that the "OTS would no longer identify its regulations on prepayment . . . charges" as applicable to state housing creditors under the Parity Act. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 20,468 (Apr. 25, 2002) (Proposed Rulemaking). In other words, under the OTS's Proposed Rulemaking, 12 *C.F.R.* § 560.220 will no longer incorporate 12 *C.F.R.* § 560.34. Therefore, the OTS will no longer authorize state-chartered housing creditors, like their federal counterparts, to charge prepayment penalties on AMTs made under the Parity Act. *Ibid.*

Of significant importance to this case are the OTS's stated reasons for its Proposed Rulemaking. First, in the Proposed Rulemaking, the OTS repudiated its 1996 decision to incorporate 12 *C.F.R.* § 560.34 into 12 *C.F.R.* § 560.220, and thus to regulate prepayment penalties on AMTs issued by state-chartered housing creditors under the Parity Act. The OTS also repudiated the *OTS 1996 Opinion Letter,* in which the OTS expressed that Wisconsin's statutory restrictions on prepayment fees were preempted by the Parity Act. The OTS stated that, in its opinion, both decisions were not well-reasoned. Indeed, the OTS admitted that its decision, in 1996, to incorporate 12 *C.F.R.* § 560.34 into 12 *C.F.R.* § 560.220, was not supported by any reasoning at all. 67 *Fed. Reg.* at 20,469-70, n.17. In so stating, the OTS tacitly admitted that 12 *C.F.R.*

§ 560.220, to the extent it incorporates 12 *C.F.R.* § 560.34, is arbitrary and capricious, and unlawful. If the OTS is correct on this point, then plaintiff's claims, challenging the prepayment fee under state laws which prohibit prepayment penalties, are not preempted by 12 *C.F.R.* § 560.220, because it is an invalid regulation. *Fidelity,* 458 *U.S.* at 154, 102 *S. Ct.* at 3023, 73 *L. Ed. 2d* at 675.

Second, in the Notice of Proposed Rulemaking, the OTS suggested the agency's current belief that its decision, in 1996, to incorporate 12 *C.F.R.* § 560.34 into 12 *C.F.R.* § 560.220, and thus to regulate prepayment penalties on AMTs issued by state-chartered housing creditors under the Parity Act, exceeded the scope of authority delegated to the OTS, by Congress, under the Parity Act. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* at 20,469-70. Specifically, the OTS states that, in its current opinion:

> prepayment . . . fee provisions are not intrinsic to the ability to offer alternative mortgages.
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> [*Id.* at 24,670.]

While the OTS recognized that state housing creditors might view its Proposed Rulemaking as having a discriminatory impact on their ability to offer alternative mortgages, the OTS noted that:

> States that restrict prepayment penalties . . . generally apply those restrictions to all real estate loans, not just to alternative mortgage transactions. The states' laws in these areas are not directed at restricting alternative mortgage transactions but in regulating mortgage transactions in general.
>
> [*Ibid.*]

Moreover, the OTS examined the intent of the Parity Act, and the scope of the Parity Act's preemption clause, stating as follows:

> One of the congressional findings underlying the Parity Act was that OTS and the other federal regulators had adopted regulations authorizing their federally chartered institutions to offer alternative mortgages, and that the purpose of the Act was to eliminate the discriminatory impact of those regulations. *[The] OTS regulation[ ] on prepayment penalties [12 C.F.R. § 560.34] . . . however, [was] not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts the flexibility to exercise their lending powers under a uniform federal scheme. See 12 C.F.R. 560.2(a). Therefore, OTS does not believe that Congress intended that regulations such as [12 C.F.R. § 560.34] would offer a basis for claiming discriminatory treatment or were needed to provide parity with federally-chartered institutions.* Indeed, OTS broadly allows federal thrifts to impose loan-related fees (e.g., initial charges and servicing fees) on any loan including alternative mortgages, notwithstanding any state law to the contrary. OTS also allows federal thrifts to process and originate any loan including alternative mortgages, without regard to state law. There is no basis for distinguishing prepayment penalties . . . from these other OTS rules that apply generally to loans.
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> [*Ibid.* (footnotes omitted) (emphasis added).]

These statements reflect at least a tacit admission by the OTS that, to the extent 12 *C.F.R.* § 560.220 incorporates 12 *C.F.R.* § 560.34, and thus regulates prepayment penalties on AMTs issued by state-chartered housing

creditors under the Parity Act, it is not "an accommodation Congress would have sanctioned" as an appropriate exercise of the Parity Act's preemption clause, because it is not necessary to effectuate Congress's goals in passing the Parity Act. *Fidelity,* 458 *U.S.* at 154, 102 *S. Ct.* at 3023, 73 *L. Ed. 2d* at 675. If the OTS is correct on this point, then plaintiff's state law claims, challenging the prepayment fee, are not preempted by 12 *C.F.R.* § 560.220, which is an invalid regulation. *Ibid.*

Thus, both of the OTS's stated reasons for its Proposed Rulemaking question the very foundation upon which the holdings of *Shinn, Face,* and *Benay,* are based – the legality of 12 *C.F.R.* § 560.220, the OTS's decision, in 1996, to regulate state-chartered housing creditors' assessment of prepayment penalties on AMTs made under the Parity Act. In our opinion, the OTS's Notice of Proposed Rulemaking requires that the holdings of *Shinn, Face,* and *Benay* be subjected to greater scrutiny, based upon the arguments put forth by the OTS. We disagree with defendant's contention that the Proposed Rulemaking does not constitute an acknowledgment by the OTS that 12 *C.F.R.* § 560.220 is ultra vires. That contention is unsupported by the language used in the Proposed Rulemaking.

OTS's September 26, 2002, Final Rulemaking

On September 26, 2002 the OTS adopted the Proposed Rulemaking as final, and explicitly adopted the findings and conclusions it had made in the Proposed Rulemaking. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 60,542, 60,544 (Sept. 26, 2002) (Final Rulemaking).

The OTS also criticized Congress for not giving the applicable federal agencies sufficient guidance in how to exercise their delegated regulatory authority under the Parity Act. In the OTS's opinion, this lack of clarity has resulted in inconsistencies in approach, both between the three federal agencies and within the OTS. More specifically, the OTS noted that, originally, the FHLBB took a narrow view of its regulatory authority under the Parity Act; only in 1996 did the OTS take the expanded view with which the agency now disagrees. *Id.* at 60,543-45.

In the OTS's present opinion, the agency may not regulate those aspects of AMTs which are applicable to real estate lending in general – such as prepayment fees – which the OTS does not believe are essential for parity. The OTS reasoned that, in passing the Parity Act, Congress did not intend to place state housing creditors under the supervision of federal agencies; indeed, Congress left room for state action by specifically reserving specific areas to the states. Moreover, had Congress intended to regulate prepayment penalties, it is unlikely Congress would have adopted the statutory scheme found in the Parity Act – allowing three different federal agencies to promulgate regulations, each of which, at the time the Parity Act was passed, took a different approach to prepayment penalties. *Id.* at 60,543-48.

Nevertheless, the OTS concluded that the various approaches taken between and among the three federal agencies demonstrated that the scope of the Parity Act's preemption was "susceptible to a number of interpretations." *Id.* at 60,544. While the OTS now disagreed with the approach taken in 1996, the OTS did not believe the approach taken in 1996 represented an "impermissible construction" of the Parity Act. Rather it represented a

choice between "two permissible interpretations" of the Parity Act. *Id.* at 60,550. Therefore, the OTS did not believe its present position was inconsistent with the decisions in *Face* and *Shinn*. *Id.* at 60,546-47, n.26.

Finally, the OTS stated that it would not apply its Final Rulemaking retroactively, to loans consummated before the effective date. *Id.* at 60,550. It recognized that to do so "would seriously disrupt the mortgage markets," and the OTS did not believe that it could take away or impair vested rights acquired under a lawfully issued and effective regulation. *Ibid.*

On December 12, 2002 the OTS delayed the effective date of its final rule, published on September 26, 2002, *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* 60,5421 (Sep. 26, 2002). The effective date of the new rule has been extended for six months, to July 1, 2003, in order to permit state-chartered housing creditors additional time to determine applicable legal requirements under state law, reprogram systems and rewrite documents, and conduct training of their employees and agents. *Alternative Mortgage Transaction Parity Act; Preemption Delay of Effective Date,* 67 *Fed. Reg.* 76,304 (Dec. 12, 2002). Therefore, 12 *C.F.R.* § 560.220, the validity of which is at issue in the present *Glukowsky* litigation, will remain in effect through July 1, 2003. The OTS's decision to defer implementation of its new rule points to the difficulties housing creditors face in complying with regulations on a state-by-state basis.

Decision on Preemption Issue

We believe that Congress's intent in passing the Parity Act was narrow and the scope of its preemption

clause is also narrow. In our opinion, in passing the Parity Act, Congress neither intended to nor authorized the OTS to issue 12 *C.F.R.* § 560.220, to the extent that regulation purports to preempt state laws which limit or prohibit the assessment of prepayment penalties on AMTs.

We agree with the reasoning set forth in the OTS's Notice of Proposed Rulemaking. In accordance with that reasoning, we find that 12 *C.F.R.* § 560.220 is invalid to the extent it incorporates 12 *C.F.R.* § 560.34, thereby regulating prepayment penalties assessed by state-chartered housing creditors on AMTs covered by the Parity Act. Furthermore, as will be discussed, in our opinion, *Shinn, Face*, and *Benay,* as well as the *OTS 1996 Opinion Letter,* were incorrectly decided because they did not give proper consideration to: (1) Congress's limited purpose in passing the Parity Act, to create a national market for AMTs; or (2) Congress's limited intent, through the Parity Act's preemption provision, to preempt only those state laws which prohibit or interfere with a housing creditor's ability to make, purchase, or enforce AMTs.

We hold that, to the extent 12 *C.F.R.* § 560.220 incorporates the regulation of prepayment penalties under 12 *C.F.R.* § 560.34, and applies 12 *C.F.R.* § 560.34 to AMTs issued by state-chartered housing creditors, it is unlawful, because it exceeds the scope of authority Congress delegated to the OTS under the Parity Act.

Congress Had a Limited Purpose in Passing the Parity Act

Congress's stated purpose in passing the Parity Act was to provide non-federally chartered housing creditors parity with federally chartered housing creditors *"by*

authorizing" non-federally chartered housing creditors to make, purchase, and enforce AMTs. 12 *U.S.C.A.* § 3801(b) (emphasis added). Nothing in the Parity Act indicates that it was directed at anything other than achieving the limited purpose of creating a national market for AMTs, making AMTs available throughout the United States.

The purpose of the Parity Act could not have been, as defendant argues, and as the federal courts suggested in *Shinn, Face,* and *Benay,* to create complete parity between federally and non-federally chartered housing creditors, so that every AMT, throughout the nation, must contain, or at least offer, the same terms, down to the minutiae of regulating the fees and penalties which may be imposed. This would involve a much broader purpose by Congress expressed in the Parity Act. It would involve a purpose to regulate the national market for AMTs which Congress created through the Parity Act – wholly supplanting state regulation of mortgage transactions, at least with respect to AMTs, and replacing it with a pervasive, uniform scheme of federal regulations applicable to AMTs.

If this were Congress's intent in passing the Parity Act, we would have expected Congress to so state. Nothing in the Parity Act indicates such a broad purpose. Moreover, if this were Congress's intent, to effectuate such a broad purpose would require significantly more federal regulation of AMTs than currently exists. In this regard, we observe that the OTS currently has only two regulations relating to alternative mortgage transactions: 12 *C.F.R.* § 560.210 and 12 *C.F.R.* § 560.220.

Indeed, the California Court of Appeals recently noted the "dearth" of federal regulations governing AMTs, in

rejecting a broad interpretation of the Parity Act's purpose. Specifically, the California court stated:

> Respondents argue that . . . the purpose of the Parity Act is the achievement of absolute parity with federally chartered lending institutions. . . .
>
> We are not persuaded by respondents' expansive view of Congress's purpose in enacting the Parity Act. Of course, absolute parity would achieve the results that Congress sought, but so would much less, such as simply authorizing non-federally chartered housing creditors to engage in alternative mortgage financing. The statute as a whole, in particular the permission retained by the states to regulate housing creditors (see 12 *U.S.C.* § 3802(2)), counsels against respondents' generous interpretation of congressional purpose, an interpretation that would permit non-federally chartered housing creditors to present information to borrowers in a misleading, distorted or even inaccurate fashion with impunity because of the lack of *federal* regulation.
>
> For similar reasons, respondents' contention that the goal of the Parity Act is national uniformity in the regulation of state-chartered housing lenders with respect to alternative mortgage transactions is also flawed. *Given the dearth of applicable federal regulations, the national uniform standard for state-chartered housing lenders would be "anything goes." That is hardly a uniform standard.*
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> [*Black,* 112 *Cal. Rptr.*2d at 457 (emphasis added).]

To recognize federal regulations as the exclusive regulation of AMTs would create an intolerable situation, whereby housing creditors could attempt to structure their

mortgage loans to make them AMTs, thereby avoiding state consumer protection laws, applicable to all mortgage transactions, in favor of the "no holds barred" federal scheme applicable to AMTs. The OTS noted this effect in its Proposed Rulemaking, remarking that consumer groups and States had complained that "state housing creditors are taking advantage of OTS regulations on prepayment penalties . . . by structuring otherwise fixed-rate, fixed term loans with features to make them alternative mortgages and thus avoid state restrictions on these charges," thereby piggybacking on federal preemption to facilitate predatory practices. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* at 20,469.

Finally, supporting a finding that the Parity Act has a limited purpose to create a national market for AMTs, and not a broad purpose to regulate the terms of all AMTs issued throughout the nation, is the fact that the Parity Act makes no mention at all of the specific terms which must be available for AMTs, and makes no mention whatsoever of fees or charges which must be allowed for AMTs. The OTS noted the significance of this fact in its Proposed Rulemaking stating specifically: "It is of note that the Parity Act makes no reference to fees or penalties nor does it direct the federal regulators to consider their impact on alternative mortgages." *Id.* at 20,470, n.19.

Indeed, one could read the Parity Act as anticipating that there would be diversity in the terms offered by AMTs because the Parity Act: (1) expressly grants states the authority to opt out of the federal scheme, 12 *U.S.C.A.* § 3804(a); and (2) provides that three different federal agencies have regulatory authority in this area of law, depending upon the nature of the entity being regulated (bank, credit union, or "all other housing creditors"). 12

U.S.C.A. § 3803(a).[2] This is something the OTS noted in its Final Rulemaking. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* at 60,545-46.

Given Congress's limited purpose in enacting the Parity Act to create a national market for AMTs, we cannot conclude that 12 *C.F.R.* § 560.220 may be viewed as a valid exercise of the authority delegated to the OTS by Congress, under the Parity Act – at least to the extent 12 *C.F.R.* § 560.220 purports to regulate state-chartered housing creditors' assessment of prepayment penalties on AMTs covered by the Parity Act, by incorporating 12 *C.F.R.* § 560.34. Section 12 *C.F.R.* § 560.220's incorporation and application of 12 *C.F.R.* § 560.34 to state-chartered housing creditors goes well beyond the intent of Congress to create a national market for AMTs. It reflects a purpose not intended by Congress, to regulate the market for AMTs created by the Parity Act. We find it invalid.

The Parity Act's Preemption Clause Reflects Congress's Limited Purpose, To Preempt Only Those State Laws Which Prohibit or Interfere with a Housing Creditor's Ability to Make, Purchase, or Enforce AMTs

The Parity Act's preemption clause also reflects Congress's intent to preempt state law in only a limited

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[2] As plaintiff points out and as the OTS recognized in its Proposed Rulemaking, 67 *Fed. Reg.* at 20469, the relevant federal agencies have taken different approaches to prepayment penalties. For example, one of the relevant federal agencies, the National Credit Union Administration, prohibits prepayment fees for national credit unions, 12 *U.S.C.A.* § 757(5)(A)(viii), whereas the Office of the Comptroller of the Currency, and the OTS have permitted prepayment fees for the entities they regulate. 67 *Fed. Reg.* at 20469.

way. It provides that: "[a]n alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation." 12 *U.S.C.A.* § 3803(c).

In our opinion, this language reflects a limited intent by Congress, to preempt only those state laws which prohibit or interfere with a housing creditor's ability to "make, purchase, [or] enforce" AMTs. 28 *U.S.C.A.* § 3801. Significantly, this is also the interpretation by the Office of the Attorney General for the State of New Jersey.

Specifically, in a March 6, 1987 Opinion Letter to the Commissioner of the New Jersey Department of Banking, Deputy Attorney General Barbara S. Goldsmith expressed that the Parity Act was not meant to occupy the field of regulating AMTS. Rather, "Congress intended to countenance state involvement in this area." Thus, Goldsmith concluded that the [sic] "the Parity Act preempts only those provisions of State law which disallow the making, purchase or enforcement of alternative mortgage transactions or which conflict with the regulations . . . deemed to be applicable to housing creditors," assuming, of course that those regulations are valid.

The California Court of Appeals has also adopted this interpretation. Specifically, in *Black,* 112 *Cal. Rptr.* 2d at 455, the California Court of Appeals considered the Parity Act's preemption clause, in a different context than the present case, and concluded that the language was

> susceptible to at least two interpretations. On one hand, the phrase "state constitution, law, or regulation" is modified with the adjective "any," supporting the argument that the preemption provision precludes all state regulations of

> alternative mortgage transactions involving state-chartered housing creditors.
>
> On the other hand, the phrase "any state constitution, law, or regulation" can be interpreted as implicitly limited to those that prohibit or impede alternative mortgage transactions or that *conflict* with federal regulations deemed applicable to non-federally chartered housing creditors, i.e., the regulations that the transaction must be made "in accordance with."
>
> [*Id.* at 455.]

That court went on to recognize that other provisions of the Parity Act supported the latter, narrower interpretation of the preemption clause. Therefore, the court adopted this narrower interpretation. *Id.* at 455-58.

Through the Parity Act, Congress clearly granted OTS regulatory authority to preempt state law, 12 *U.S.C.A.* § 3801(a)(3) and 3803(a). However, that regulatory authority must be viewed as limited by Congress's limited preemptive intent, as expressed in the Parity Act's preemption clause, 12 *U.S.C.A.* § 3803(c), to preempt *only* those state laws which prohibit or interfere with a housing creditor's ability to "make, purchase, [or] enforce" AMTs, 12 *U.S.C.A.* § 3801.

Under this limited view of the Parity Act's preemption clause, it is clear to us that 12 *C.F.R.* § 560.220 goes well beyond Congress's preemptive intent, to the extent it incorporates 12 *C.F.R.* § 560.34, because prepayment penalties do not prohibit or interfere with a housing creditor's ability to make, purchase, or enforce AMTs. Indeed, prepayment fees are not unique to AMTs. They are common to traditional mortgages, as well as other consumer loans.

Thus, prepayment fees cannot be viewed as limiting the availability of AMTs, any more than they may be viewed as limiting the availability of traditional mortgages or other forms of consumer financing.

The OTS recognized this fact in both its recent Proposed Rulemaking and Final Rulemaking. Specifically, the OTS remarked that: (1) state prohibitions against or limitations of prepayment fees are not directed at prohibiting or limiting the availability of AMTs; and (2) the OTS regulation, authorizing prepayment penalties, 12 *C.F.R.* § 560.34, was not adopted by the OTS in order to enable federally chartered housing creditors to engage in AMTs. Thus, there is no legitimate reason to apply 12 *C.F.R.* § 560.34 to state-chartered housing creditors, with respect to AMTs covered by the Parity Act, as the OTS did in 1996, by incorporating 12 *C.F.R.* § 560.34 into 12 *C.F.R.* § 560.220. *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* at 20,470; *Alternative Mortgage Transaction Parity Act; Preemption,* 67 *Fed. Reg.* at 60,544-46.

Indeed, it is extremely significant that the OTS's 1996 incorporation of 12 *C.F.R.* § 560.34 into 12 *C.F.R.* § 560.220, and thus its decision to regulate prepayment fees with respect to state-chartered housing creditors' AMTs, represented a significant change in policy, and a significant expansion of the OTS's jurisdiction. As plaintiff's brief points out, contrary to the OTS's 1996 position, in 1983, the FHLBB took a much more limited view of its role in regulating state-chartered housing creditors' AMTs, under the Parity Act. Specifically, the FHLBB took the position that, under the Parity Act, it should apply to state-chartered housing creditors, only "*those regulatory provisions that describe and define alternative mortgage*

transactions," and not "*those provisions that apply generally to mortgage loans*" such as prepayment penalties. *Implementation of New Powers; Limitation on Loans to One Borrower,* 48 *Fed. Reg.* 23032, 23058 (May 23, 1983) (emphasis added). The FHLBB's more limited approach was "premised on the clear statement of Congressional intent that [the Parity Act] 'does not place non-federally chartered housing creditors under the supervision of the federal agencies, but instead merely enables them to follow a federal program as an alternative to state law.'" *Ibid.* (quoting *S. Rep. No.* 97-463, 97th Cong., 2d Sess. 55).

Thus, because it conflicts with the OTS's prior interpretation, the OTS's decision in 1996 to regulate prepayment fees with respect to AMTs by incorporating 12 *C.F.R.* § 560.34 into 12 *C.F.R.* § 560.220 is "'entitled to considerably less deference'" from this court. *Good Samaritan Hosp. v. Shalala,* 508 *U.S.* 402, 417, 113 *S. Ct.* 2151, 2161, 124 *L. Ed.* 2d 368, 383 (1993) (quoting *Watt v. Alaska,* 451 *U.S.* 259, 273, 101 *S. Ct.* 1673, 1681, 68 *L. Ed.* 2d 80, 92 (1981)). *See also,* Brown & Williamson, *153* F.3d at 162 (closer scrutiny suggested where an agency is attempting to expand the scope of its jurisdiction).

Finally, defendant's reliance upon *Turner,* 162 *N.J.* 75, as to the broad scope of the OTS's delegated authority, is inapposite, and somewhat misleading. In *Turner,* our Supreme Court recognized that, under the HOLA, Congress granted the OTS broad authority to regulate federal savings and loan associations, and the OTS occupied the field of lending regulation for federal savings and loan associations. Therefore, there was no room for state regulation of federal savings and loan associations. *Id.* at 88-94. That is not the question posed in the present case. Here, the question is the scope of authority delegated to

the OTS, under the Parity Act, to regulate AMTs issued by state-chartered-housing creditors.

V

Turning to the question of whether the complaint states a claim upon which relief may be granted, in reviewing a complaint dismissed under *R.* 4:6-2(e) our inquiry is limited to examining the legal sufficiency of the facts alleged on the face of the complaint. We must not concern ourselves with the plaintiff's ability to prove those allegations. *Printing Mart-Morristown v. Sharp Elec. Corp.,* 116 *N.J.* 739, 746 (1989). The complaint should be searched "'in depth and with liberality to ascertain whether the fundament of a cause of action may be gleaned even from an obscure statement of claim, opportunity being given to amend if necessary.'" *Ibid.* (quoting *Di Cristofaro v. Laurel Grove Mem'l Park,* 43 *N.J. Super.* 244, 252 (App. Div. 1957)). Our analysis must be "at once painstaking and undertaken with a generous and hospitable approach," with every reasonable inference of fact granted to the plaintiff, and with the recognition that such motions should be approached with caution, and granted only in the rarest of instances. *Printing Mart-Morristown,* 116 *N.J.* at 746, 771-72. *Accord, R.* 4:5-7; *Spring Motors Distribs., Inc. v. Ford Motor Co.,* 191 *N.J. Super.* 22, 29-30 (App. Div. 1983), *aff'd in part and rev'd in part on other grounds,* 98 *N.J.* 555 (1985). *Cf., R.* 4:5-2 (complaint must contain statement of facts upon which claims are based, showing pleader is entitled to relief sought).

Whether the Complaint Stated a Claim for Violation of The Prepayment Law

Presuming plaintiff's allegations to be true, defendant's collection of a prepayment fee for the prepayment in full of the mortgage violates the Prepayment Law. *N.J.S.A.* 46:10B-2. Defendant contends that *N.J.S.A.* 46:10B-2 does not prohibit prepayment fees despite its clear language to that effect. Defendant contends that, read together, *N.J.S.A.* 46:10B-2 and *N.J.S.A.* 46:10B-3 must be interpreted as permitting residential mortgage lenders to charge a prepayment fee, if the mortgage is prepaid, in full, during the first eighteen months of the mortgage. We find no support for this argument in the statutory language.

N.J.S.A. 46:10B-2[3] and *N.J.S.A.* 46:10B-3[4] address two entirely different scenarios. *N.J.S.A.* 46:10B-2 addresses the *entire* prepayment of a residential mortgage, and expressly prohibits the collection of a prepayment fee

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[3] *N.J.S.A.* 46:10B 2 states:

Prepayment of a mortgage loan may be made by or on behalf of a mortgagor at any time without penalty.

[4] *N.J.S.A.* 46:10B 3 states:

A mortgagor shall have the right, during any 6 month period beginning with the date of the mortgage loan, to pay, without charge or penalty, an additional sum of $50.00, or multiples thereof, on account of the principal amount owing on a mortgage loan, provided that the additional sums so paid and the principal payments required to be made by the terms of such mortgage loan during such 6 month period do not together exceed in any such 6 month period 33-1/3% of the face amount of such mortgage loan. The right to make additional payments as provided by this section shall not be cumulative, and to the extent that it is not exercised during any 6 month period, shall lapse.

under those circumstances. *N.J.S.A.* 46:10B-2 in no way limits its prohibition of prepayment fees to the period eighteen months or more after the mortgage is executed. Indeed, *N.J.S.A.* 46:10B-2 explicitly states that a mortgage may be prepaid, in full, without penalty, "at any time." Thus, *N.J.S.A.* 46:10B-2 is directly applicable to the facts of this case, and directly prohibits the conduct in which defendant allegedly engaged.

N.J.S.A. 46:10B-3 addresses the *partial* prepayment of a mortgage loan. It provides that, under limited circumstances, mortgage borrowers may make *partial* prepayments of a mortgage, without being assessed a prepayment penalty. *N.J.S.A.* 46:10B-3 is not implicated in this case, which does not involve the partial prepayment of a mortgage. We see nothing in *N.J.S.A.* 46:10B-3 which limits its applicability to the first eighteen months of a mortgage loan, as defendant contends. Rather, the appropriate interpretation of *N.J.S.A.* 46:10B-3 is that it applies during *any* six-month period over the life of a mortgage loan.

The Legislature's reasons for distinguishing between full and partial prepayment of a mortgage are irrelevant here. But we note that there may be legitimate reasons for treating the situations differently. For example, total prepayment of a mortgage typically occurs when the mortgaged property has been sold or the mortgage has been refinanced. The Legislature may have wished to protect residential mortgage borrowers from prepayment charges under those circumstances.

Partial prepayment of a mortgage, over multiple payment periods, however, imposes transaction costs upon the mortgage lender. *N.J.S.A.* 46:10B-3 appears to be a

recognition of that fact, and an attempt to resolve the conflicting interests of borrower and lender, by limiting the circumstances under which borrowers may make partial prepayments without incurring a fee. Viewed in this light, *N.J.S.A.* 46:10B-3 simultaneously limits to an extent the transaction costs imposed on mortgage lenders, while protecting the rights of mortgage borrowers to make partial prepayments.

We reject defendant's interpretation of *N.J.S.A.* 46:10B-2 and *N.J.S.A.* 46:10B-3 and hold that they do not permit the collection of a prepayment fee, if a mortgage is prepaid, in full, during the first eighteen months of the loan.

We hold that Count One of the complaint states a valid claim under New Jersey's Prepayment Law, *N.J.S.A.* 46:10B-2, which is not preempted by federal law.

VI

Under its express terms, the Market Rate Consumer Loan Act, *N.J.S.A.* 17:3B-4 to -27, does not apply to defendant. Defendant does not fit within the statutory definition of a "lender," since defendant is not a bank, a federally chartered savings bank, or an association. Rather, the record shows that defendant is licensed by the State of New Jersey as, among other things, a "mortgage banker" under the New Jersey Licensed Lenders Act. *N.J.S.A.* 17:11C-1 to -49. Defendant has submitted copies of its licenses to substantiate this fact. Plaintiff's argument is without merit. The complaint fails to state a claim upon which relief may be granted under the Market Rate Act. We affirm the dismissal of Count Two of the complaint.

VII

Plaintiff also alleges that defendant violated the Licensed Lenders Act, *N.J.S.A.* 17:11C-23, and one of the regulations adopted under the Licensed Lenders Act, *N.J.A.C.* 3:15-10.1(b). We could reject this claim because plaintiff neither pleaded it in the complaint nor moved to amend the complaint to state such a claim. *Brown v. Tp. of Old Bridge,* 319 *N.J. Super.* 476, 501 (App.Div.), *certif. denied,* 162 *N.J.* 131 (1999); *Skripek v. Bergamo,* 200 *N.J. Super.* 620, 629 (App. Div.), *certif. denied,* 102 *N.J.* 303 (1985). We choose to address the argument because there is a potentially valid claim under *N.J.A.C.* 3:15-10.1(b).

Plaintiff is incorrect in claiming that *N.J.S.A.* 17:11C-23 prohibits the collection of prepayment fees. *N.J.S.A.* 17:11C-23 limits the fees licensed lenders may charge "incidental to the origination, processing and closing of a mortgage loan transaction." This section has nothing to say with respect to prepayment fees. The applicable section of the New Jersey Administrative Code, *N.J.A.C.* 3:1-16.2(c), however, states that it "does not restrict the imposition of fees *after* the closing of a mortgage loan" (emphasis added) – an example of which would be a prepayment fee.

N.J.A.C. 3:15-10.1, however, does prohibit entities licensed under the Licensed Lenders Act from charging prepayment fees. It specifically provides that "[a] borrower may repay a first mortgage loan, second mortgage loan or consumer loan at any time without penalty."

The claim asserted under *N.J.S.A.* 17:11C-23 is rejected as without merit but on remand, within 60 days of the date of this decision, plaintiff is permitted to amend the complaint, to assert a claim under *N.J.A.C.* 3:15-10.1.

The claim is not preempted by federal law but, of course, may be subject to other valid defenses or challenges.

VIII

We decline to address the Consumer Fraud Claim, which was not ruled upon by the trial court. We also decline to address several of plaintiff's claims which were not pleaded in the complaint: (1) the claim that the prepayment clause is unconscionable and unenforceable under general principles of contract law because the prepayment fee is unconscionable in amount; and (2) the claim that the collection of a prepayment fee violates the federal "due-on-sale" regulation, 12 *C.F.R.* § 591.5(b)(2)(i). In view of the need for a remand, plaintiff may amend his complaint to assert these claims within 60 days of the date of this decision.

IX

We reverse in part and affirm in part. We hold that: (1) plaintiff's state law claims are not preempted by 12 *C.F.R.* § 560.220 because this regulation exceeds the scope of authority Congress delegated to the OTS under the Parity Act; (2) we remand for further proceedings on plaintiff's claims under the Prepayment Law and the Consumer Fraud Act; and (3) we affirm dismissal of plaintiff's claim under the Market Rate Consumer Loan Act because defendant is not an entity covered by this statute. On the remand the plaintiff may amend his complaint to articulate claims under (1) the federal "due-on-sale" regulation, 12 *C.F.R.* § 591.5(b)(2)(i); (2) a state regulation adopted under the Licensed Lenders Act, *N.J.A.C.* 3:15-10.1; and (3) general contract principles,

prohibiting unconscionable contract terms. We, of course, indicate no view on the merits of these claims.

X

Finally, the parties did not brief the issue of whether this court's decision, if a reversal, should apply retroactively or prospectively.

> In determining retroactive application of a new rule, four judicial options are available: (1) make the new rule of law purely prospective, applying it only to cases whose operative facts arise after the new rule is announced; (2) apply the new rule to future cases and to the parties in the case announcing the new rule, while applying the old rule to all other pending and past litigation; (3) grant the new rule limited retroactivity, applying it to cases in (1) and (2) as well as to pending cases where the parties have not yet exhausted all avenues of direct review [pipeline retroactivity]; and, finally, (4) give the new rule complete retroactive effect, applying it to all cases, even those where final judgments have been entered and all avenues of direct review exhausted.
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> [*State v. Yanovsky,* 340 *N.J. Super.* 1, 8 (App. Div. 2001), quoting *State v. Burstein,* 85 *N.J.* 394, 402-03 (1981).]

"The determination of retroactive application is generally guided by three factors: '(1) the purpose of the rule and whether it would be furthered by a retroactive application, (2) the degree of reliance placed on the old rule by those who administered it, and (3) the effect a retroactive application would have on the administration of justice.'" *Id.* at 9 (quoting *State v. Knight,* 145 *N.J.* 233, 251 (1996)

(citation and internal quotations omitted)). *See also, Alderiso v. Medical Center,* 167 *N.J.* 191 (2001); *SASCO 1997 NI, LLC v. Zudkewich,* 166 *N.J.* 579, 596 (2201) [sic].

The issue of retroactivity raises questions which have not been addressed by the parties. We leave this issue to the Law Division judge, in the first instance.

Affirmed in part; reversed in part, and remanded.

SUPREME COURT OF NEW JERSEY
M-1296 September Term 2003
54,996

MARK GLUKOWSKY,

Plaintiff-Movant,

v.

EQUITY ONE, INC.,

Defendant.

ORDER

(Filed Jun. 17, 2004)

This matter having been duly presented to the Court, it is ORDERED that the motion for reconsideration of the Opinion is denied.

WITNESS, the Honorable Deborah T. Poritz, Chief Justice, at Trenton, this 15th day of June, 2004.

/s/ Stephen Townsend
CLERK OF THE SUPREME COURT

12 U.S.C. § 3801. Findings and purpose

(a) The Congress hereby finds that –

(1) increasingly volatile and dynamic changes in interest rates have seriously impared[1] the ability of housing creditors to provide consumers with fixed-term, fixed-rate credit secured by interests in real property, cooperative housing, manufactured homes, and other dwellings;

(2) alternative mortgage transactions are essential to the provision of an adequate supply of credit secured by residential property necessary to meet the demand expected during the 1980's; and

(3) the Comptroller of the Currency, the National Credit Union Administration, and the Director of the Office of Thrift Supervision have recognized the importance of alternative mortgage transactions and have adopted regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing.

(b) It is the purpose of this chapter to eliminate the discriminatory impact that those regulations have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies.

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[1] So in original. Probably should be "impaired".

12 U.S.C. § 3802. Definitions

As used in this chapter –

(1) the term "alternative mortgage transaction" means a loan or credit sale secured by an interest in residential real property, a dwelling, all stock allocated to a dwelling unit in a residential cooperative housing corporation, or a residential manufactured home (as that term is defined in section 5402(6) of Title 42) –

(A) in which the interest rate or finance charge may be adjusted or renegotiated;

(B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or

(C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation; described and defined by applicable regulation; and

(2) the term "housing creditor" means –

(A) a depository institution, as defined in section 501(a)(2) of the Depository Institutions Deregulation and Monetary Control Act of 1980;

(B) a lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act (12 U.S.C.A. § 1701 et seq.);

(C) any person who regularly makes loans, credit sales, or advances secured by interests in properties referred to in paragraph (1); or

(D) any transferee of any of them.

A person is not a "housing creditor" with respect to a specific alternative mortgage transaction if, except for this chapter, in order to enter into that transaction, the person would be required to comply with licensing requirements imposed under State law, unless such person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law.

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12 U.S.C. § 3803. Alternative mortgage authority

(a) General authority; compliance by banks, credit unions and all other housing creditors with applicable regulations

In order to prevent discrimination against State-chartered depository institutions, and other nonfederally chartered housing creditors, with respect to making, purchasing, and enforcing alternative mortgage transactions, housing creditors may make, purchase, and enforce alternative mortgage transactions, except that this section shall apply –

(1) with respect to banks, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the Comptroller of the Currency for national banks, to the extent that such regulations are authorized by rule-making authority granted to the Comptroller of the Currency with regard to national banks under laws other than this section;

(2) with respect to credit unions, only to transactions made in accordance with regulations governing

alternative mortgage transactions as issued by the National Credit Union Administration Board for Federal credit unions, to the extent that such regulations are authorized by rulemaking authority granted to the National Credit Union Administration with regard to Federal credit unions under laws other than this section; and

(3) with respect to all other housing creditors, including without limitation, savings and loan associations, mutual savings banks, and savings banks, only to transactions made in accordance with regulations governing alternative mortgage transactions as issued by the Director of the Office of Thrift Supervision for federally chartered savings and loan associations, to the extent that such regulations are authorized by rulemaking authority granted to the Director of the Office of Thrift Supervision with regard to federally chartered savings and loan associations under laws other than this section.

(b) Transactions deemed in compliance with applicable regulations

For the purpose of determining the applicability of this section, an alternative mortgage transaction shall be deemed to be made in accordance with the applicable regulation notwithstanding the housing creditor's failure to comply with the regulation, if –

(1) the transaction is in substantial compliance with the regulation; and

(2) within sixty days of discovering any error, the housing creditor corrects such error, including making appropriate adjustments, if any, to the account.

(c) Preemption of State constitutions, laws or regulations

An alternative mortgage transaction may be made by a housing creditor in accordance with this section, notwithstanding any State constitution, law, or regulation.

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12 U.S.C. § 3804. Applicability of preemption provisions

(a) The provisions of section 3803 of this title shall not apply to any alternative mortgage transaction in any State made on or after the effective date (if such effective date occurs on or after October 15, 1982, and prior to a date three years after October 15, 1982) of a State law or a certification that the voters of such State have voted in favor of any provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the preemption provided in section 3803 of this title to apply with respect to alternative mortgage transactions (or to any class or type of alternative mortgage transaction) subject to the laws of such State, except that section 3803 of this title shall continue to apply to –

(1) any alternative mortgage transaction undertaken on or after such date pursuant to an agreement to undertake such alternative mortgage transaction which was entered into on or after October 15, 1982, and prior to such later date (the "preemption period"); and

(2) any renewal, extension, refinancing, or other modification of an alternative mortgage transaction that was entered into during the preemption period.

(b) An alternative mortgage transaction shall be deemed to have been undertaken during the preemption period to which this section applies if it –

(1) is funded or extended in whole or in part during the preemption period, regardless of whether pursuant to a commitment or other agreement therefor made prior to that period; or

(2) is a renewal, extension, refinancing, or other modification of an alternative mortgage transaction entered into before the preemption period and such renewal, extension, or other modification is made during such period with the written consent of any person obligated to repay such credit.

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12 U.S.C. § 3805. Applicability of consumer protection provisions

Section 501(c)(1) of the Depository Institutions Deregulation and Monetary Control Act of 1980 shall not apply to transactions which are subject to this chapter.

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12 U.S.C. § 3806. Adjustable rate mortgage caps

(a) In general

Any adjustable rate mortgage loan originated by a creditor shall include a limitation on the maximum interest rate that may apply during the term of the mortgage loan.

(b) Regulations

The Board of Governors of the Federal Reserve System shall prescribe regulations to carry out the purposes of this section.

(c) Enforcement

Any violation of this section shall be treated as a violation of the Truth in Lending Act (15 U.S.C. § 1601 et seq.) and shall be subject to administrative enforcement under section 108 (15 U.S.C. § 1607) or civil damages under section 130 of such Act (15 U.S.C. § 1640), or both.

(d) Definitions

For the purpose of this section –

(1) the term "creditor" means a person who regularly extends credit for personal, family, or household purposes; and

(2) the term "adjustable rate mortgage loan" means any consumer loan secured by a lien on a one- to four-family dwelling unit, including a condominium unit, cooperative housing unit, or mobile home, where the loan is made pursuant to an agreement under which the creditor may, from time to time, adjust the rate of interest.

(e) Effective date

This section shall take effect upon the expiration of 120 days after August 10, 1987.

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12 U.S.C. § 1735f-7. Exemption from State usury laws; applicability

(a) The provisions of the constitution of any State expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved by lenders and the provisions of any State law expressly limiting the rate or amount of interest, discount points, or other charges which may be charged,

taken, received, or reserved shall not apply to any loan, mortgage, or advance which is insured under subchapter I or II of this chapter.

(b) The provisions of subsection (a) of this section shall apply to loans, mortgages, or advances made or executed in any State until the effective date (after December 21, 1979) of a provision of law of that State limiting the rate or amount of interest, discount points, or other charges on any such loan, mortgage, or advance.

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12 U.S.C.A. § 1735f-7 – Notes

SOURCE

(June 27, 1934, ch. 847, title V, Sec. 529, as added Pub. L. 96-153, title III, Sec. 308, Dec. 21, 1979, 93 Stat. 1113.)

CHOICE OF HIGHEST APPLICABLE INTEREST RATE

In any case in which one or more provisions of, or amendments made by, title V of Pub. L. 96-221 (enacting sections 86a, 1730g, 1735f-7a, 1785(g), and 1831d of this title and section 687(i) of Title 15, Commerce and Trade, and enacting provisions set out as notes under sections 86a, 1730g, and 1735f-7a of this title), this section, or any other provisions of law, including section 85 of this title, apply with respect to the same loan, mortgage, credit sale, or advance, such loan, mortgage, credit sale, or advance may be made at the highest applicable rate, see section 528 of Pub. L. 96-221, set out as a note under section 1735f-7a of this title.

STATE CONSTITUTION OR LAWS LIMITING INTEREST, DISCOUNT POINTS, OR OTHER CHARGES; EXEMPTION UNTIL CLOSE OF MARCH 31, 1980

Pub. L. 96-161, title I, § 105, Dec. 28, 1979, 93 Stat. 1234, as amended by Pub. L. 96-221, title V, § 529, Mar. 31, 1980, 94 Stat. 168, provided that (a)(1) the provisions of the constitution or law of any State expressly limiting the rate or amount of interest, discount points, or other charges which could be charged, taken, received, or reserved were not to apply to any loan, mortgage, or advance which was secured by a first lien on residential real property or by a first lien on stock in a residential cooperative housing corporation where the loan, mortgage, or advance was used to finance the acquisition of such stock; made after Dec. 28, 1979; and described in section 1735f-5(b) of this title, except that the limitation described in section 1735f-5(b)(1) of this title that the property must be designed principally for the occupancy of from one to four families was not to apply, the requirement contained in section 1735f(5)(b)(1) of this title that the loan be secured by residential real property was not to apply to a loan secured by stock in a residential cooperative housing corporation, and for the purpose of this section, the term "lender" in section 1735f-5(b)(2)(A) of this title was also to be deemed to include any lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under this chapter; (2) (Repealed by Pub. L. 96-221, title V, § 529, Mar. 31, 1980, 94 Stat. 168, eff. at the close of Mar. 31, 1980.); that (b) the provisions of subsection (a)(1) were to apply to loans, mortgages, and advances made in any State unless and until the State adopted a provision of law (prior to the

close of March 31, 1980) limiting the rate or amount of interest, discount points, or other charges on any such loan, mortgage, or advance, except that at any time after Dec. 28, 1979, any State could adopt a provision of law placing limitations on discount points or such other charges on any such loan, mortgage, or advance; that (c) the Federal Home Loan Bank Board was authorized to issue rules and regulations and to publish interpretations governing the implementation of this section; that (d) the provisions of subsection (a)(1) expired at the close of March 31, 1980, except that such provisions were to continue to apply to any loan, mortgage, or advance described in subsection (a)(1) for the duration of such loan, mortgage, or advance if made prior to such expiration or if made during the two-year period beginning on Dec. 28, 1979, pursuant to a commitment issued prior to such expiration, and that (e) for the purpose of this Act (Pub. L. 96-161) and any amendment made by this Act (see Tables for classification of Pub. L. 96-161), the term "State" included the several States, Puerto Rico, the District of Columbia, Guam, the Trust Territories of the Pacific Islands, and the Virgin Islands.

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12 U.S.C.A. § 1735f-7a. State constitution or laws limiting mortgage interest, discount points, and finance or other charges; exemption for obligations made after March 31, 1980

(a) Applicability to loan, mortgage, credit sale, or advance; applicability to deposit, account, or obligation

(1) The provisions of the constitution or the laws of any State expressly limiting the rate or amount of interest, discount points, finance charges, or other charges

which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, credit sale, or advance which is –

(A) secured by a first lien on residential real property, by a first lien on all stock allocated to a dwelling unit in a residential cooperative housing corporation, or by a first lien on a residential manufactured home;

(B) made after March 31, 1980; and

(C) described in section 527(b) of the National Housing Act (12 U.S.C. 1735f-5(b)), except that for the purpose of this section –

(i) the limitation described in section 527(b)(1) of such Act that the property must be designed principally for the occupancy of from one to four families shall not apply;

(ii) the requirement contained in section 527(b)(1) of such Act that the loan be secured by residential real property shall not apply to a loan secured by stock in a residential cooperative housing corporation or to a loan or credit sale secured by a first lien on a residential manufactured home;

(iii) the term "federally related mortgage loan" in section 527(b) of such Act shall include a credit sale which is secured by a first lien on a residential manufactured home and which otherwise meets the definitional requirements of section 527(b) of such Act as those requirements are modified by this section;

(iv) the term "residential loans" in section 527(b)(2)(D) of such Act shall also include loans

or credit sales secured by a first lien on a residential manufactured home;

(v) the requirement contained in section 527(b)(2)(D) of such Act that a creditor make or invest in loans aggregating more than $1,000,000 per year shall not apply to a creditor selling residential manufactured homes financed by loans or credit sales secured by first liens on residential manufactured homes if the creditor has an arrangement to sell such loans or credit sales in whole or in part, or if such loans or credit sales are sold in whole or in part to a lender, institution, or creditor described in section 527(b) of such Act or in this section or a creditor, as defined in section 103(f) of the Truth in Lending Act (15 U.S.C. § 1602(f)), as such section was in effect on the day preceding March 31, 1980, if such creditor makes or invests in residential real estate loans or loans or credit sales secured by first liens on residential manufactured homes aggregating more than $1,000,000 per year; and

(vi) the term "lender" in section 527(b)(2)(A) of such Act shall also be deemed to include any lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act (12 U.S.C. § 1701 et seq.), and any individual who finances the sale or exchange of residential real property or a residential manufactured home which such individual owns and which such individual occupies or has occupied as his principal residence.

(2) The provisions of the constitution or law of any State expressly limiting the rate or amount of interest which may be charged, taken, received, or reserved shall not apply to any deposit or account held by, or other

obligation of a depository institution. For purposes of this paragraph, the term "depository institution" means –

(i) any insured bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(ii) any mutual savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(iii) any savings bank as defined in section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813);

(iv) any insured credit union as defined in section 101 of the Federal Credit Union Act (12 U.S.C. 1752);

(v) any member as defined in section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1422); and

(vi) any insured institution as defined in section 408[1] of the National Housing Act (12 U.S.C. 1730a).

(b) Applicability to loan, mortgage, credit sale, or advance made in any State after April 1, 1980

(1) Except as provided in paragraphs (2) and (3), the provisions of subsection (a)(1) of this section shall apply to any loan, mortgage, credit sale, or advance made in any State on or after April 1, 1980.

(2) Except as provided in paragraph (3), the provisions of subsection (a)(1) of this section shall not apply to any loan, mortgage, credit sale, or advance made in any State after the date (on or after April 1, 1980, and before April 1, 1983) on which such State adopts a law or certifies that the voters of such State have voted in favor of any

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[1] See References in Text note below.

provision, constitutional or otherwise, which states explicitly and by its terms that such State does not want the provisions of subsection (a)(1) of this section to apply with respect to loans, mortgages, credit sales, and advances made in such State.

(3) In any case in which a State takes an action described in paragraph (2), the provisions of subsection (a)(1) of this section shall continue to apply to –

(A) any loan, mortgage, credit sale, or advance which is made after the date such action was taken pursuant to a commitment therefor which was entered during the period beginning on April 1, 1980, and ending on the date on which such State takes such action; and

(B) any loan, mortgage, or advance which is a rollover of a loan, mortgage, or advance, as described in regulations of the Federal Home Loan Bank Board, which was made or committed to be made during the period beginning on April 1, 1980, and ending on the date on which such State takes any action described in paragraph (2).

(4) At any time after March 31, 1980, any State may adopt a provision of law placing limitations on discount points or such other charges on any loan, mortgage, credit sale, or advance described in subsection (a)(1) of this section.

(c) Applicability to loan, mortgage, credit sale, or advance secured by first lien on residential manufactured home

The provisions of subsection (a)(1) of this section shall not apply to a loan, mortgage, credit sale, or advance which is secured by a first lien on a residential manufactured

home unless the terms and conditions relating to such loan, mortgage, credit sale, or advance comply with consumer protection provisions specified in regulations prescribed by the Federal Home Loan Bank Board. Such regulations shall –

(1) include consumer protection provisions with respect to balloon payments, prepayment penalties, late charges, and deferral fees;

(2) require a 30-day notice prior to instituting any action leading to repossession or foreclosure (except in the case of abandonment or other extreme circumstances);

(3) require that upon prepayment in full, the debtor shall be entitled to a refund of the unearned portion of the precomputed finance charge in an amount not less than the amount which would be calculated by the actuarial method, except that the debtor shall not be entitled to a refund which is less than $1; and

(4) include such other provisions as the Federal Home Loan Bank Board may prescribe after a finding that additional protections are required.

(d) Implementation of provisions applicable to residential manufactured home

The provisions of subsection (c) of this section shall not apply to a loan, mortgage, credit sale, or advance secured by a first lien on a residential manufactured home until regulations required to be issued pursuant to paragraphs (1), (2), and (3) of subsection (c) of this section take effect, except that the provisions of subsection (c) of this section shall apply in the case of such a loan, mortgage, credit sale, or advance made prior to the date on which such regulations take effect if the loan, mortgage, credit

sale, or advance includes a precomputed finance charge and does not provide that, upon prepayment in full, the refund of the unearned portion of the precomputed finance charge is in an amount not less the amount which would be calculated by the actuarial method, except that the debtor shall not be entitled to a refund which is less than $1. The Federal Home Loan Bank Board shall issue regulations pursuant to the provisions of paragraphs (1), (2), and (3) of subsection (c) of this section that shall take effect prospectively not less than 30 days after publication in the Federal Register and not later than 120 days from March 31, 1980.

(e) Definitions

For the purpose of this section –

(1) a "prepayment" occurs upon –

(A) the refinancing or consolidation of the indebtedness;

(B) the actual prepayment of the indebtedness by the consumer whether voluntarily or following acceleration of the payment obligation by the creditor; or

(C) the entry of a judgment for the indebtedness in favor of the creditor;

(2) the term "actuarial method" means the method of allocating payments made on a debt between the outstanding balance of the obligation and the precomputed finance charge pursuant to which a payment is applied first to the accrued precomputed finance charge and any remainder is subtracted from, or any deficiency is added to, the outstanding balance of the obligation;

(3) the term "precomputed finance charge" means interest or a time price differential within the meaning of sections 106(a)(1) and (2) of the Truth in Lending Act (15 U.S.C. 1605(a)(1) and (2)) as computed by an add-on or discount method; and

(4) the term "residential manufactured home" means a manufactured home as defined in section 603(6) of the National Mobile Home Construction and Safety Standards Act of 1974 (42 U.S.C. § 5402(6)) which is used as a residence.

(f) Rules, regulations, and interpretations

The Federal Home Loan Bank Board is authorized to issue rules and regulations and to publish interpretations governing the implementation of this section.

(g) Effective date

This section takes effect on April 1, 1980.

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12 U.S.C. § 1735f-7a – Notes

SOURCE

(Pub. L. 96-221, title V, Sec. 501, Mar. 31, 1989, 94 Stat. 161; Pub. L. 96-221, title II, Sec. 207(b)(11), Mar. 31, 1980, 94 Stat. 144; Pub. L. 96-399, title III, Sec. 308(c)(6), 324(a), (e), Oct. 8, 1980, 94 Stat. 1641, 1647, 1648; Pub. L. 97-35, title III, Sec. 384, Aug. 13, 1981, 95 Stat. 432.)

REFERENCES IN TEXT

The National Housing Act, referred to in subsec. (a), is Act June 27, 1934, ch. 847, 48 Stat. 1246, as amended, which is classified principally to this chapter (Sec. 1701 et

seq.). Section 408 of the National Housing Act, which was classified to section 1730a of this title, was repealed by Pub. L. 101-73, title IV, Sec. 407, Aug. 9, 1989, 103 Stat. 363. For complete classification of this Act to the Code, see section 1701 of this title and Tables.

CODIFICATION

Section was enacted as part of the Depository Institutions Deregulation and Monetary Control Act of 1980, and not as part of the National Housing Act which comprises this chapter.

AMENDMENTS

1981 – Subsec. (a)(1)(C)(vi). Pub. L. 97-35 inserted referenced to a residential manufactured home.

1980 – Subsec. (a)(1)(A). Pub. L. 96-399, Sec. 324(a), substituted "all stock allocated to a dwelling unit" for first reference to "stock" and struck out "where the loan, mortgage, or advance is used to finance the acquisition of such stock" after "housing corporation".

Subsec. (a)(1)(C)(vi). Pub. L. 96-399, Sec. 324(e), inserted reference to any person who finances the sale or exchange of residential real property which such individual owns and which such individual occupies or has occupied as his principal residence.

Subsec. (a)(2). Pub. L. 96-221, Sec. 207(b)(11), struck out "(A)" after "(2)" and struck out subpar. (B) which provided that this paragraph shall not apply to any such deposit, account, or obligation which is payable only at an office of an insured bank, as defined in section 3 of the

Federal Deposit Insurance Act, located in the Commonwealth of Puerto Rico.

Subsec. (e)(4). Pub. L. 96-399, Sec. 308(c)(6), substituted "manufactured" for "mobile".

EFFECTIVE DATE OF 1980 AMENDMENT

Section 207(b) of Pub. L. 96-221 provided in part that the amendment made by that section is effective 6 years after Mar. 31, 1980.

SEVERABILITY

Section 526 of Pub. L. 96-221 provided that: "If any provision of this Act (for classification of act to the Code, see Short Title of 1980 Amendment note set out under section 226 of this title and Tables) or the application of such provision to any person or circumstance shall be held invalid, the remainder of this Act and the application of such provision to any person or circumstance other than that as to which it is held invalid shall not be affected thereby."

TRANSFER OF FUNCTIONS

Federal Home Loan Bank Board abolished and functions transferred, see sections 401 to 406 of Pub. L. 101-73, set out as a note under section 1437 of this title.

CHOICE OF HIGHEST
APPLICABLE INTEREST RATE

Pub. L. 96-221, title V, Sec. 528, Mar. 31, 1980, 94 Stat. 168, provided that: "In any case in which one or more

provisions of, or amendments made by, this title (enacting sections 86a, 1730g, 1735f-7a, and 1831d of this title, amending section 1785 of this title and section 687 of Title 15, Commerce and Trade, and enacting provisions set out as notes under sections 86a, 1730g, and 1735f-7 of this title), section 529 of the National Housing Act (section 1735f-7 of this title), nor any other provision of law, including section 5197 of the Revised Statutes (12 U.S.C. 85), apply with respect to the same loan, mortgage, credit sale, or advance, such loan, mortgage, credit sale, or advance may be made at the highest applicable rate."

DEFINITION OF "STATE"

Section 527 of title V of Pub. L. 96-221, as amended by Pub. L. 96-221, title II, Sec. 207(b)(12), Mar. 31, 1980, 94 Stat. 144, provided that: "For purposes of this title (enacting sections 86a, 1730g, 1735f-7a, and 1831d of this title, amending section 1785 of this title and section 687 of Title 15, Commerce and Trade, and enacting provisions set out as notes under sections 86a, 1730g, 1735f-7, and 1735f-7a of this title) the term 'State' includes the several States, the Commonwealth of Puerto Rico, the District of Columbia, Guam, the Trust Territories of the Pacific Islands, the Northern Mariana Islands, and the Virgin Islands."

(Section 207(b) of Pub. L. 96-221 provided that the amendment of above note made by that section is effective 6 years after Mar. 31, 1980.)

(For termination of Trust Territory of the Pacific Islands, see note set out preceding section 1681 of Title 48, Territories and Insular Possessions.)

SECTION REFERRED TO IN OTHER SECTIONS

This section is referred to in sections 1831u, 3506 of this title.

12 C.F.R. § 560.34 (Effective Sept. 26, 2002)

§ 560.34 Prepayments.

Any prepayment on a real estate loan must be applied directly to reduce the principal balance on the loan unless the loan contract or the borrower specifies otherwise. Subject to the terms of the loan contract, a Federal savings association may impose a fee for any prepayment of a loan.

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12 C.F.R. § 560.220 Alternative Mortgage Transaction Parity Act.

(a) *Applicable housing creditors.* A housing creditor that is not a commercial bank, a credit union, or a federal savings association, may make an alternative mortgage transaction as defined at 12 U.S.C. 3802(1), by following the regulations identified in paragraph (b) of this section, notwithstanding any state constitution, law, or regulation. *See* 12 U.S.C. 3803.

(b) *Applicable regulations.* OTS identifies §§ 560.35 and 560.210 as appropriate and applicable for state housing creditors. All other OTS regulations are not identified, and are inappropriate and inapplicable for state housing creditors. State housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable in applying these regulations.

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12 C.F.R. § 560.34 (1996 to Pre September 2002)

§ 560.34 Prepayments.

Any prepayment on a real estate loan must be applied directly to reduce the principal balance on the loan unless

the loan contract or the borrower specifies otherwise. Subject to the terms of the loan contract, a Federal savings association may impose a fee for any prepayment of a loan.

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12 C.F.R. § 560.220 Alternative Mortgage Parity Act.

Pursuant to 12 U.S.C. 3803, housing creditors that are not commercial banks, credit unions, or Federal savings associations may make alternative mortgage transactions as defined by that section and further defined and described by applicable regulations identified in this section, notwithstanding any state constitution, law, or regulation. In accordance with section 807(b) of Public Law 97-320, 12 U.S.C. 3801 note, §§ 560.33, 560.34, 560.35, and 560.210 of this part are identified as appropriate and applicable to the exercise of this authority and all regulations not so identified are deemed inappropriate and inapplicable. Housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable.

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12 C.F.R. § 590.1 Authority, purpose, and scope.

(a) *Authority*. This part contains regulations issued under section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 161.

(b) *Purpose and scope*. The purpose of this permanent preemption of state interest-rate ceilings applicable to Federally-related residential mortgage loans is to ensure that the availability of such loans is not impeded in

states having restrictive interest limitations. This part applies to loans, mortgages, credit sales, and advances, secured by first liens on residential real property, stock in residential cooperative housing corporations, or residential manufactured homes as defined in § 590.2 of this part.

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§ 590.2 Definitions.

For the purposes of this part, the following definitions apply:

(a) *Loans* mean any loans, mortgages, credit sales, or advances.

(b) *Federally-related loans* include any loan:

(1) Made by any lender whose deposits or accounts are insured by any agency of the Federal government;

(2) Made by any lender regulated by any agency of the Federal government;

(3) Made by any lender approved by the Secretary of Housing and Urban Development for participation in any mortgage insurance program under the National Housing Act;

(4) Made in whole or in part by the Secretary of Housing and Urban Development; insured, guaranteed, supplemented, or assisted in any way by the Secretary or any officer or agency of the Federal government, or made under or in connection with a housing or urban development program administered by the Secretary, or a housing or related program administered by any other such officer or agency;

(5) Eligible for purchase by the Federal National Mortgage Association, the Government National Mortgage Association, or the Federal Home Loan Mortgage Corporation, or made by any financial institution from which the loan could be purchased by the Federal Home Loan Mortgage Corporation; or

(6) Made in whole or in part by any entity which:

(i) Regularly extends, or arranges for the extension of, credit payable by agreement in more than four installments or for which the payment of a finance charge is or may be required; and

(ii) Makes or invests in residential real property loans, including loans secured by first liens on residential manufactured homes that aggregate more than $1,000,000 per year; except that the latter requirement shall not apply to such an entity selling residential manufactured homes and providing financing for such sales through loans or credit sales secured by first liens on residential manufactured homes, if the entity has an arrangement to sell such loans or credit sales in whole or in part, or where such loans or credit sales are sold in whole or in part, to a lender or other institution otherwise included in this section.

(c) *Loans which are secured by first liens on real estate* means loans on the security of any instrument (whether a mortgage, deed of trust, or land contract) which makes the interest in real estate (whether in fee, or in a leasehold or subleasehold extending, or renewable, automatically or at the option of the holder or the lender, for a period of at least 5 years beyond the maturity of the loan) specific security for the payment of the obligation secured by the instrument: *Provided*, That the instrument

is of such a nature that, in the event of default, the real estate described in the instrument could be subjected to the satisfaction of the obligation with the same priority as a first mortgage of a first deed of trust in the jurisdiction where the real estate is located.

(d) *Loans secured by first liens on stock in a residential cooperative housing corporation* means loans on the security of:

(1) A first security interest in stock or a membership certificate issued to a tenant stockholder or resident member by a cooperative housing organization; and

(2) An assignment of the borrower's interest in the proprietary lease or occupancy agreement issued by such organization.

(e) *Loans secured by first liens on residential manufactured homes* means a loan made pursuant to an agreement by which the party extending the credit acquires a security interest in the residential manufactured home which will have priority over any conflicting security interest.

(f) *Residential real property* means real estate improved or to be improved by a structure or structures designed primarily for dwelling, as opposed to commercial use.

(g) *Residential manufactured home* shall mean a manufactured home as defined in the National Manufactured Home Construction and Safety Standards Act, 42 U.S.C. 5402(6), which is or will be used as a residence.

(h) *State* means the several states, Puerto Rico, the District of Columbia, Guam, the Trust Territories of the

Pacific Islands, the Northern Mariana Islands, and the Virgin Islands, except as provided in section 501(a)(2)(B) of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 161.

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§ 590.3 Operation.

(a) The provisions of the constitution or law of any state expressly limiting the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved shall not apply to any Federally-related loan:

(1) Made after March 31, 1980; and

(2) Secured by a first lien on:

(i) Residential real property;

(ii) Stock in a residential cooperative housing corporation when the loan is used to finance the acquisition of such stock; or

(iii) A residential manufactured home: *Provided*, That the loan so secured contains the consumer safeguards required by § 590.4 of this part;

(b) The provisions of paragraph (a) of this section shall apply to loans made in any state on or before the date (after April 1, 1980 and prior to April 1, 1983) on which the state adopts a law or certifies that the voters of such state have voted in favor of any law, constitutional or otherwise, which states explicitly and by its terms that such state does not want the provisions of paragraph (a) of this section to apply with respect to loans made in such state, except that –

(1) The provisions of paragraph (a) of this section shall apply to any loan which is made after such date pursuant to a commitment therefore which was entered into during the period beginning on April 1, 1980, and ending on the date the state takes such action;

(2) The provisions of paragraph (a) of this section shall apply to any rollover of a loan which loan was made, or committed to be made, during the period beginning on April 1, 1980, and ending on the date the state takes such action, if the mortgage document or loan note provided that the interest rate to the original borrower could be changed through the use of such a rollover; and

(3) At any time after the date of adoption of these regulations, any state may adopt a provision of law placing limitations on discount points or such other charges on any loan described in this part.

(c) Nothing in this section preempts limitations in state laws on prepayment charges, attorneys' fees, late charges or other provisions designed to protect borrowers.

N.J.S.A. § 46:10B-1. Definitions.

As used in this act:

(a) "Mortgage loan" means a loan secured by an interest in real property consisting of land upon which is erected or to be erected, in whole or in part with the proceeds of such loan, a structure containing one, two, three, four, five or six dwelling units, a portion of which structure may be used for nonresidential purposes and upon which interest is taken or contracted for at a rate in excess of $6.00 for the forbearance of $100.00 for a year;

(b) "Mortgagor" includes any person other than a corporation liable for the payment of a mortgage loan, and the owner of the real property which secures the payment of a mortgage loan;

(c) "Prepayment" of a mortgage loan means the payment in full of the balance owing on a mortgage loan at any time prior to the time limited for the final payment of such loan in an instrument evidencing such loan.

N.J.S.A. § 46:10B-2. Prepayment of mortgage loan without penalty.

Prepayment of a mortgage loan may be made by or on behalf of a mortgagor at any time without penalty.

N.J.A.C. § **3:15**-1.1 Purpose and scope

(a) This chapter implements the New Jersey Licensed Lenders Act, N.J.S.A. 17:11C-1 et seq.

(b) This chapter shall apply to all licensed lenders with mortgage banker, correspondent mortgage banker, mortgage broker, secondary lender, consumer lender and/or sales finance company authority or authorities and registered mortgage solicitors and those whose activities require they be licensed or registered.

N.J.A.C. § **3:15**-1.2 Definitions

The following words and terms, when used in this chapter, shall have the following meaning unless the context clearly indicates otherwise.

"Accrual basis of accounting" means the accounting method by which expenses are recorded when incurred, whether paid or unpaid, and income is recorded when earned, whether received or not received.

"Act" means the "New Jersey Licensed Lenders Act," N.J.S.A. 17:11C-1 et seq.

"Advertisement" means any announcement, statement, assertion, or representation that is placed before the public in a newspaper, magazine, or other publication or in the form of a notice, circular, pamphlet, letter or poster or over any radio or television station, by means of the internet or by other electronic means of distributing information, or in any other way.

"Alternate name" means an alternate name registered pursuant to N.J.S.A. 14A:2-2.1(2) or 42:2B-4b.

"Application" means the document or documents or information, including the payment of any fees, that a particular lender or broker requires a borrower to submit for the

purpose of having the lender or broker begin to process the loan document or documents to determine whether to grant or deny a loan.

"Application fee" shall have the meaning of that term in N.J.A.C. 3:1-16.2. "Appraisal fee" shall have the meaning of that term in N.J.A.C. 3:1-16.2.

"Authority" means one of the activities permitted for a licensee pursuant to the Act: either mortgage banker, correspondent mortgage banker or mortgage broker; secondary lender; consumer lender; or sales finance business.

"Biennial period" means the two-year period beginning on July 1 of an odd-numbered year.

"Billing cycle" means the time interval between periodic billing dates. A billing cycle shall be considered monthly if the closing date of the cycle is the same date each month or does not vary by more than four days from such date.

"Borrower" means any person applying for a loan from a lender licensed under the Act, whether or not the loan is granted, and any person who has actually obtained such a loan.

"Branch office" means any location where, in the regular course of business, applications for first mortgage loans, second mortgage loans, consumer loans or sales finance contracts are distributed to or received from consumers, loan records are maintained, underwriting decisions are made, commitments or lock-in agreements are issued, or any fees or charges relating to the loan are received from consumers.

1. A home or place of business of a consumer shall not be considered a branch office.

2. A location shall not be considered a branch office merely because any or all of the following activities are conducted at the location:

i. Consumers receive information concerning available loan products from a computer terminal;

ii. Consumers are prequalified for a loan, so long as no additional fee is charged for this service; and

iii. Advertising materials are distributed to consumers so long as the materials do not in any way resemble an application for a loan.

3. A branch office of a licensee under the Act does not also constitute a branch office of another licensee merely because the first licensee distributes or receives applications of that other licensee at the branch office.

4. A principal or branch office of a bank, savings bank, savings and loan association or credit union shall not also constitute a branch office of a licensee merely because the bank, savings bank, savings and loan association or credit union distributes or receives applications of the licensee at the principal or branch office.

5. A licensed real estate office of a person licensed as a real estate broker or salesman pursuant to N.J.S.A. 45:15-1 et seq., does not constitute a branch of an entity licensed as a mortgage banker, correspondent mortgage banker or mortgage broker under the Act merely because the real estate broker or salesman distributes or receives an application of the entity licensed as a mortgage banker, correspondent mortgage banker or mortgage broker at

that office, or because an entity licensed as a mortgage banker, correspondent mortgage banker or mortgage broker under the Act or a solicitor of that licensee who does not hold himself out to the public as performing mortgage banking, correspondent mortgage banking, or mortgage brokering there and does not maintain an office or desk there meets at the office of the real estate broker as a convenience to the borrower and distributes or receives applications or fees there.

"Closed-end loan" with respect to a secondary mortgage loan means a loan pursuant to which the licensee advances a specified amount of money and the borrower agrees to repay the principal and interest in substantially equal installments over a stated period of time, except that: the amount of the final installment payment may be substantially greater than the previous installments if the term of the loan is at least 36 months, or under 36 months if the remaining term of the first mortgage loan is under 36 months; or the amount of the installment payments may vary as a result of the change in the interest rate as permitted by the Act. "Closed-end loan" with respect to a consumer loan means a loan pursuant to which the licensee advances a specified amount of money and the borrower agrees to repay the principal and interest in substantially equal installments over a stated period of time and which meets the requirements of N.J.S.A. 17:11C-35.

"Commissioner" means the Commissioner of the Department of Banking and Insurance.

"Commitment" means a signed statement issued by a lender in which the lender promises to make a loan of specified terms to a specified borrower, and which is based

on a satisfactory underwriting analysis of the appraisal, if an appraisal is required in connection with the loan, and satisfactory underwriting analysis of the credit report, if a credit report is required in connection with the loan, except that any document indicating approval of a loan application that is contingent on the approval of a party to whom the lender seeks to sell the loan shall not be deemed a commitment.

"Commitment fee" shall have the meaning of that term in N.J.A.C. 3:1-16.2.

"Consumer lender" means a person licensed, or a person who should be licensed, under the Act to engage in the consumer loan business.

"Consumer loan" means a loan of $ 50,000 or less made by a consumer lender pursuant to the terms of the Act, and not a first mortgage loan or a secondary mortgage loan.

"Consumer loan business" means the business of making loans of money, credit, goods or things in action in the amount of value of $ 50,000 or less and charging, contracting for, or receiving a greater rate of interest, discount or consideration therefore than the lender would be permitted by law to charge if he or she were not a licensee hereunder, except as authorized by the Act and without first obtaining a license from the Commissioner. Any person directly or indirectly engaging in the business of soliciting or taking applications for such loans of $ 50,000 or less, or in the business or negotiating or arranging or aiding the borrower or lender in procuring or making such loans of $ 50,000 or less, or in the business of buying, discounting or indorsing notes, or of furnishing, or procuring guarantee or security for compensation in amounts of

$ 50,000 or less, shall be deemed to be engaging in the consumer loan business.

"Controlling interest" means ownership, control or interest of 25 percent or more of the licensee or applicant.

"Correspondent mortgage banker" means a mortgage banker who:

1. In the regular course of business, does not hold mortgage loans in its portfolio, or service mortgage loans, for more than 90 days; and

2. Has shown to the Department's satisfaction an ability to fund loans through warehouse agreements, table funding agreements or otherwise.

"Credit report fee" shall have the meaning of that term in N.J.A.C. 3:1-16.2.

"Department" means the Department of Banking and Insurance.

"Depository institution" means any entity holding a state or Federal charter for a bank, savings bank, savings and loan association or credit union, irrespective of whether the entity accepts deposits.

"Direct contact" means in-person contact, and contact by means of a telephone, computer terminal, internet or other electronic means during which contact, in the regular course of business, applications for first mortgage loans, second mortgage loans, consumer loans or sales finance contracts are distributed to or received from consumers, underwriting decisions are made, commitments or lock-in agreements are issued, or any fees or charges relating to the loan are authorized.

"Discount point" shall have the meaning of that term in N.J.A.C. 3:1-16.2.

"First mortgage loan" means any loan secured by a first mortgage on real property on a one to six family dwelling, a portion of which may be used for nonresidential purposes.

"Insolvent" means having negative tangible net worth, or being unable to pay debts when due.

"Lender" means a bank, savings bank, savings and loan association, credit union, mortgage banker, correspondent mortgage banker, secondary lender, consumer lender, sales finance company or any other person who originates loans in this State.

"License name" means any name listed on the license issued by the Department including the true name and any alternate or trade names.

"Licensed lender" or "licensee" means a person who is licensed pursuant to the Act with one or more authorities.

"Liquid assets" means cash, marketable securities, and accounts receivable.

"Lock-in agreement" means an agreement between the lender and the borrower whereby the lender guarantees until a specified date the availability of a specified rate of interest or time price differential or specified formula by which the rate of interest or time price differential will be determined and/or specific number discount points, provided the loan is approved and closed by the specified date. If a specified date is not determinable, the lender may fulfill the requirement of this provision by setting forth with specificity the method by which the duration of the

lock-in period will be determined. The term "lock-in agreement" does not include as agreement to fix the rate executed three or fewer calendar days before closing where appropriate disclosures have been made under the provisions of this chapter.

"Lock-in fee" shall have the meaning of that term in N.J.A.C. 3:1-16.2.

"Mortgage banker" means any person, not exempt under section 4 of the Act and licensed pursuant to the provisions of the Act, and any person who should be licensed pursuant to the provisions of the Act, who for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly originates, acquires or negotiates first mortgage loans in the primary market.

"Mortgage broker" means any person, not exempt under section 4 of the Act and licensed pursuant to the provisions of the Act, and any person who should be licensed pursuant to the provisions of the Act, who for compensation or gain, or in the expectation of compensation or gain, either directly or indirectly negotiates, places or sells for others or offers to negotiate, place or sell for others, first mortgage loans in the primary market.

"Mortgage loan" means any loan secured by a mortgage on real property on a one- to six-family dwelling, a portion of which structure may be used for nonresidential purposes.

"Mortgage solicitor" means any person not licensed as a mortgage banker, correspondent mortgage banker, or mortgage broker who is employed as a solicitor by one, and not more than one, licensee, who is subject to the direct supervision and control of that licensee, and who solicits, provides or accepts first mortgage loan applications, or

assists borrowers in completing first mortgage loan applications, and whose compensation is in any way based on the dollar amount or volume of first mortgage loan applications, first mortgage closings or other first mortgage loan activity.

"Open-end loan" means a secondary mortgage loan made by a secondary lender or a consumer loan made by a consumer lender pursuant to a written agreement with the borrower whereby:

1. The secondary lender or consumer lender may permit the borrower to obtain advances of money from the secondary lender or consumer lender from time to time or the secondary lender or consumer lender may advance money on behalf of the borrower form [sic] time to time as directed by the borrower;

2. The amount of each advance and permitted interest and charges are debited to the borrower's account and payments and other credits are credited to the same account;

3. Interest is computed on the unpaid principal balance or balances of the account from time to time; and

4. The borrower has the privilege of paying the account in full at any time or, if the account is not in default, in monthly installments of fixed or determinable amounts as provided in the agreement.

"Originate" means to commit to make a mortgage loan, or to close a mortgage loan in the name of the licensee.

"Person" means an individual, association, joint venture, partnership, limited partnership association, limited

liability company, corporation, trust, or any other group of individuals however organized.

"Prequalification" means the process whereby a licensee prior to application advises a person whether or not he or she qualifies for a loan product, subject to satisfactory appraisal and other contingencies.

"Primary market" means the market wherein first mortgage loans are originated between a lender and a borrower, whether or not through a mortgage broker or other conduit, and shall not include the sale or acquisition of a mortgage loan after closing of the mortgage loan.

"RESPA" means the Federal Real Estate Settlement Procedures Act, 12 U.S.C. § 2607, regulations implementing RESPA, and any opinion regarding RESPA issued by the Department of Housing and Urban Development.

"Sales finance company" shall have the meaning ascribed to that term in N.J.S.A. 17:16C-1.

"Secondary lender" means a person licensed, or a person who should be licensed, under the Act to engage in the secondary mortgage loan business.

"Secondary mortgage loan" means a loan made to an individual, association, joint venture, partnership, limited partnership association, limited liability company, trust, or any other group of individuals, however organized, except a corporation, which is secured in whole or in part by a lien upon any interest in real property, including, but not limited to, shares of stock in a cooperative corporation, created by a security agreement, including a mortgage, indenture, or any other similar instrument or document, which real property is subject to one or more prior liens and on which there is erected a structure containing one,

two, three, four, five or six dwelling units, a portion of which structure may be used for nonresidential purposes, except that the following shall not be subject to the provisions of this chapter:

1. A loan that is to be repaid in 90 days or less;

2. A loan that is taken as security for a home repair contract executed in accordance with the provisions of the Home Repair Financing Act, N.J.S.A. 17:16C-62 et seq.; or

3. A loan that is the result of the private sale of a dwelling, if title to the dwelling is in the name of the seller and the seller has resided in the dwelling for at least one year, if the buyer is purchasing that dwelling for his or her own residence and, if the buyer, as a part of the purchase price, executes a secondary mortgage in favor of the seller.

"Secondary mortgage loan business" means advertising, causing to be advertised, soliciting, negotiating, offering to negotiate, offering to make or making a secondary mortgage loan in this State, whether directly or by any person acting for his or her benefit.

"Settlement service" means any service provided in connection with a real estate settlement including, but not limited to, the following: title searches, title examinations, the provision of title certificates, title insurance, services rendered by an attorney, the preparation of documents, property surveys, the rendering of credit reports or appraisals, pest and fungus inspections, services rendered by a real estate agent or broker, and the handling of the processing, and closing or settlement.

"Substantial stockholder" means a person or entity owning 10 percent or more of the stock of a licensee.

"Table funding agreement" means an agreement between an investor and a licensee whereby the investor agrees to purchase specified mortgage loans from a licensee immediately after the closing of the mortgage loans, and which permits the licensee to close with funds of the investor.

"Tangible net worth" means net worth less the following assets:

1. That portion of any assets pledged to secure obligations of any person or entity other than that of the applicant;

2. Any asset (except construction loan receivables secured by first mortgages from related companies) due from officers or stockholders of the applicant or related companies in which the applicant's officers and/or stockholders have an interest;

3. That portion of the value of any marketable security (listed or unlisted) not shown at lower of cost or market, except for any shares of FNMA stock required to be held under a servicing agreement, which should be carried at cost;

4. Any amount in excess of the lower of the cost or market value of mortgages in foreclosures, construction loans, or foreclosed property acquired by the applicant through foreclosure;

5. Any investment shown on the balance sheet in the applicant's joint ventures, subsidiaries, affiliates and/or related companies that is greater than the value of said assets at equity;

6. Goodwill;

7. The value placed on insurance renewals or property management contract renewals or other similar intangibles of the applicant;

8. Organization costs of the applicant;

9. The value of any servicing contracts held by the applicant not determined in accordance with FASB Statement No. 65, "Accounting for Certain Mortgage Banking Activities," dated September 1982, as amended by FASB No. 122, "Accounting for Mortgage Servicing Rights," dated May 1995, or subsequent revisions thereto;

10. Any real estate held for investment where development will not start within two years from the date of its initial acquisition;

11. Any leasehold improvements not being amortized over the lesser of the expected life of the asset or the remaining term of the lease; and

12. Any commitment fees paid/collected that are not recoverable through the closing or selling of loans.

"Time price differential" shall have the meaning of that term in N.J.S.A. 17:16C-1(1) and shall be computed as provided in N.J.S.A. 17:16C-41.

"Third party charges" shall have the meaning of that term in N.J.A.C. 3:1-16.2. "Trade name" means an assumed name filed pursuant to N.J.S.A. 56:1-2.

"True name" means the legal name of the licensed entity and shall not include any alternate or trade name.

"Warehouse agreement" means an agreement to provide credit to a licensee to enable the licensee to have funds to

close mortgage loans and hold those mortgage loans pending sale to permanent investors.

"Warehouse fee" shall have the meaning of that term in N.J.A.C. 3:1-16.2.

N.J.A.C. § 3:15-10.1 Provisions applicable to all licensees

(a) No licensee shall charge an interest rate that is in excess of the rate permitted by N.J.S.A. 2C:21-19.

(b) A borrower may repay a **first mortgage** loan, second mortgage loan or consumer loan at any time without penalty.

(c) A licensee may only compute interest accrued between monthly payments using the 365/365 method (actual number of days between payments) or the 360/360 method (each month assumed to be 30 days). Sales finance companies charge a time price differential on retail charge accounts rather than interest.

(d) A borrower shall be given a copy of every document he or she is required to sign.

(e) Where any disclosure is required pursuant to this chapter that is also required by any Federal law or regulation, compliance with such Federal law or regulation shall be deemed to be compliance with this subchapter.

(f) No licensee shall require, as a precondition for the granting of credit, or for any other benefit or consideration from the licensee in connection with a loan, that the borrower engage in any other business activity with the licensee. Nothing in this subsection shall prohibit a

licensee from offering to a borrower other services or products in connection with a loan.

(g) A licensee shall not require, nor receive, from a borrower a rebate of any portion of the proceeds of a loan that is not a permissible fee.

67 Fed. Reg. 20,468 (April 25, 2002)

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 560, 590 and 591

[No. 2002-17]

RIN 1550-AB51

Alternative Mortgage Transaction Parity Act; Preemption

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Alternative Mortgage Transaction Parity Act (Parity Act) authorizes state-chartered housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation. To rely on the Parity Act, certain state-chartered housing creditors must comply with regulations on alternative mortgage transactions issued by the Office of Thrift Supervision (OTS). In today's rulemaking, OTS proposes to revise its rule identifying the OTS regulations that apply to creditors under the Parity Act. OTS would no longer identify its regulations on prepayment and late charges for state housing creditors.

OTS is also proposing to revise existing limitations on the amount of late charge that may be assessed on loans secured by first liens on residential manufactured homes under part 590. Part 590 addresses the preemption of certain state usury laws for federally-related residential mortgage loans. In addition, OTS is proposing a minor technical change to the definition of reverse mortgage in

part 591, which addresses the preemption of state due-on-sale laws.

DATES: Comments must be received on or before June 24, 2002.

ADDRESSES:

Mail: Send comments to Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, Attention: Docket No. 2002-17. Commenters should be aware that there have been some unpredictable and lengthy delays in postal deliveries to the Washington, DC area in recent weeks and may prefer to make their comments via facsimile, e-mail, or hand delivery.

Delivery: Hand deliver comments to the Guard's Desk, East Lobby Entrance, 1700 G Street, NW., from 9:00 a.m. to 4:00 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Docket No. 2002-17.

Facsimiles: Send facsimile transmissions to FAX Number (202) 906-6518, Attention: Docket No. 2002-17.

E-Mail: Send e-mails to regs.comments@ots.treas.gov, Attention: Docket No. 2002-17, and include your name and telephone number.

Availability of comments: OTS will post comments and the related index on the OTS Internet Site at www.ots.treas.gov. In addition, you may inspect comments at the Public Reading Room, 1700 G St. NW., by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov. or send a facsimile transmission to (202) 906-7755. (Please identify the materials you would like to inspect to assist us in

serving you.) We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the business day after the date we receive a request.

FOR FURTHER INFORMATION CONTACT: Theresa Stark, Senior Project Manager, Compliance Policy, (202) 906-7054; Karen Osterloh, Assistant Chief Counsel, (202) 906-6639, Regulations and Legislation Division, Office of Thrift Supervision, 1700 G Street NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. The Alternative Mortgage Transaction Parity Act Regulations (s 560.220)

A. Background

Congress enacted the Parity Act[1] in 1982 to stimulate credit in an unusually high interest rate environment by encouraging variable rate mortgages and other creative financing. In hearings before the Senate in 1981, mortgage bankers testified that statutes in 26 states barred state-chartered mortgage bankers and lending institutions from originating alternative mortgage loans, or imposed significantly higher restrictions on such loans than applied to federally chartered lenders operating under federal regulations. Congress wanted to make more housing credit available by giving those state-chartered housing creditors[2] parity with federally chartered institutions and

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[1] 12 U.S.C. 3801 *et seq.*

[2] A "housing creditor" is a depository institution, a lender approved by the Secretary of Housing and Urban Development for participation in certain mortgage insurance programs, "any person who regularly makes loans, credit sales or advances secured by interests in properties

(Continued on following page)

eliminate the discriminatory impact of the state laws by authorizing those creditors to make, purchase, and enforce alternative mortgage loans.[3]

The Parity Act applies to loans with any "alternative" payment features that vary from conventional fixed-rate, fixed term mortgage loans, such as variable rates, balloon payments, or call features. It allows state licensed and regulated housing creditors to engage in "alternative mortgage transactions" notwithstanding "any State constitution, law, or regulation," provided the transactions are in conformity with regulations that would apply to a comparable federally chartered housing creditor.[4]

To qualify as a state housing creditor and take advantage of preemption, the Parity Act specifically provides that the creditor must be "licensed under applicable State law and [remain or become] subject to the applicable regulatory requirements and enforcement mechanisms provided by State law."[5] Housing creditors, other than state-chartered banks and state-chartered credit unions,[6] that wish to make an alternative mortgage transaction under the authority of the Parity Act, must abide by

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referred to in [the Parity Act]; or . . . any transferee of any of them." 12 U.S.C. 3802(2).

[3] 12 U.S.C. 3801(b). *See also National Home Equity Mortgage Association v. Face*, 64 F. Supp. 2d 584, 587 (E.D. Va. 1999), *aff'd*, 239 F.3d 633 (4th Cir. 2001), and *cert denied* 70 U.S.L.W. 3234 (U.S. Oct. 1, 2001) (No. 00-1851).

[4] *Id.*; 12 U.S.C. 3803.

[5] 12 U.S.C. 3802(2).

[6] State-chartered commercial banks and state-chartered credit unions must comply respectively with regulations of the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration (NCUA).

designated OTS regulations. Those regulations are enforced by each state housing creditor's applicable state regulator.

The Parity Act directed the Federal Home Loan Bank Board (Bank Board), OTS's predecessor agency, to identify, describe, and publish those portions of its regulations that were inappropriate for, and thus inapplicable to, non-federally chartered, non-bank, non-credit union housing creditors.[7] In 1982, the Bank Board published a "Notice to Housing Creditors" (1982 Notice).[8] The 1982 Notice provided that state housing creditors, other than commercial banks, credit unions or federal associations, may make alternative mortgage loans subject to the Bank Board's requirements on adjustments to rate, payment, balance or term of maturity and disclosure.

In 1983, the Bank Board published a final rule codifying a revised Notice to Housing Creditors. The 1983 final rule identified three provisions that were an integral part of, and particular to, alternative mortgage transactions. These included provisions governing the authority to make partially amortized or non-amortized loans and to adjust the interest rate payment, balance or term of maturity; limitations on adjustments on loans secured by borrower-occupied property; and requirements for disclosures on loans secured by borrower-occupied property that are not fixed-rated and fully amortized.[9]

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[7] Section 807 of Pub. L. 97-320 (1982).

[8] 47 Fed. Reg. 51733 (November 17, 1982).

[9] 48 Fed. Reg. 23,032, 23053 (May 23, 1983). The notice was codified as an appendix to part 545. In 1989, it was moved 12 CFR 545.33. *See* 54 FR 49492 (November 30, 1989).

When the 1982 Notice was issued, federal savings associations had a limited ability to impose prepayment penalties on alternative mortgage transactions.[10] While the ability of federal thrifts to impose prepayment penalties was expanded in 1984,[11] restrictions were not removed completely until 1993. At that time OTS allowed prepayment penalties at any time and in any amount authorized by the loan contract for both adjustable rate and fixed-rate mortgages.[12]

In January 1996, OTS proposed to designate additional rules as applicable under the Parity Act. Specifically, OTS proposed to designate all of proposed part 560 (rules on the lending powers of federal savings associations and safety and soundness-based lending provisions applicable to all savings associations) and proposed § 563.99 (fixed and adjustable-rate mortgage loan disclosures, adjustment notices, and interest rate caps).[13] In the final rule, OTS deleted the general reference to part 560, and specifically identified applicable regulations, including new references to late charges and prepayment provisions.[14] The list of OTS regulations currently applicable to state housing creditors now includes the following sections:

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[10] See 12 CFR 545.8-5(b) (1983).

[11] See 12 CFR 545.34(c) (1984).

[12] 58 FR 4308 (Jan. 14, 1993). Of course, federal thrifts must disclose prepayment penalties and late charges under the Federal Reserve Board's Regulation Z, which implements the Truth in Lending Act (15 U.S.C. 1601 *et seq.*). See 12 CFR 226.18(k) and (l).

[13] 61 FR 1162, at 1166, 1174, and 1181 (January 17, 1996).

[14] 61 FR 50951, at 50955, and 50969 (September 30, 1996).

- § 560.33. This reference permits state housing creditors to impose late charges for any delinquent periodic payment and sets out certain limitations on the assessment of such late charges.

- § 560.34. This reference permits state housing creditors to impose a prepayment penalty and indicates how prepayments must be applied.

- § 560.35. This section addresses adjustments to interest rate, adjustments to the payment and loan balance, and the use of indices.

- § 560.210. This reference requires state housing creditors to provide initial disclosures and adjustment notices for variable rate transactions.

Housing creditors must comply with these requirements to obtain the benefit of the Parity Act's preemption of state laws.

On April 5, 2000, OTS published an advance notice of proposed rulemaking (ANPR) entitled "Responsible Alternative Mortgage Lending. 65 FR 17811. The ANPR sought public comment on various questions in connection with its review of mortgage lending regulations. OTS specifically sought comment about possible amendments to § 560.220. To the extent that commenters addressed these issues, they are discussed below.

B. Proposed § 560.220

1. Comments on the ANPR

Consumer groups and states generally urged OTS to limit the applicability of the Parity Act regulations to enable the states to better regulate non-depository state housing creditors. These commenters contended that state housing creditors are taking advantage of OTS regulations on prepayment penalties and late fees by structuring otherwise fixed-rate, fixed term loans with features to make them alternative mortgages and thus avoid state restrictions on these charges. These commenters specifically suggested removing prepayment penalties and late fees provisions from the list of regulations applicable to state housing creditors because those provisions apply to all mortgage loans (not just alternative transactions), arguing that they allow non-depository institutions to piggy back on federal preemption and facilitate predatory practices.[15]

Financial institutions and their trade organizations generally supported the existing Parity Act rules as enhancing credit availability and enabling lenders to develop new mortgage options. They argued that if the scope of the Parity Act regulations were significantly narrowed, state financial institutions potentially could be required to comply with 51 sets of state requirements, and

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[15] OTS does not collect information on housing creditors that take advantage of the Parity Act. Accordingly, OTS sought data on the extent to which housing creditors taking advantage of the Parity Act are engaged in predatory practices and the effect that the Parity Act has [sic] the availability of credit. While commenters offered anecdotal information, OTS received no comprehensive data in response to the ANPR.

that this would increase lending costs to consumers. Some commenters argued the Parity Act does not limit the scope of regulations applicable to housing creditors to those provisions concerning only alternative mortgage transactions.

2. Proposed Revisions to § 560.220

OTS has reviewed the designation of the regulations on prepayments and late charges in light of the comments on the ANPR and the purposes of the Parity Act, and is proposing to delete these rules from the list of provisions that apply to state housing creditors under the Parity Act.

The Parity Act directs the Bank Board (now OTS), OCC and NCUA to identify, describe, and publish those regulations that are "inappropriate for and inapplicable" to state housing creditors. The Parity Act, however, provides little guidance to the agencies in determining which regulations are appropriate. As a result, NCUA, OCC, OTS, and the Bank Board have taken substantially different approaches to the designation of rules.

NCUA, for example, has identified *all* of its lending regulations as applicable to alternative mortgage transactions by state-chartered credit unions.[16] These mortgage regulations address such matters as the term of the loan, requirements governing security instruments, notes, and liens, due-on-sale provisions, and assumptions and, as

[16] 12 CFR 701.21(a) states "[W]hile § 701.21 generally applies to Federal credit unions only, its provisions may be used by state-chartered credit unions with respect to alternative mortgage transactions in accordance with 12 U.S.C. 3801 *et seq.*"

required under the Federal Credit Union Act, specifically prohibit prepayment penalties.

In contrast, OCC has designated as applicable to state-chartered commercial banks its rules that directly relate to adjustable rate mortgages.[17] OCC's designated regulations define ARM loans, authorize certain indexes and allow prepayment fees.

The Bank Board initially identified as appropriate and applicable those regulations that "describe and define" alternative mortgage transactions and not those regulations intended for the general supervision of federal associations. Because agency rules on prepayment penalties and late charges applied to loans generally (as distinguished from rules that bear directly on the unique features of alternative mortgage loans), the Bank Board's Parity Act regulation did not identify these provisions.

In 1996, OTS took a different tack and added provisions on prepayment and late charges to the list of designated regulations. The designation occurred as part of a larger regulatory project to update and reorganize all of its lending and investment regulations. The proposed and final rules did not explain the reason for OTS departure from its predecessor agency's standard.

The proposed rule merely stated in one sentence that OTS would identify as appropriate and applicable to alternative mortgage transactions all of part 560 and § 563.99. The preamble to the final rule, again in one sentence, merely stated that the rule was being "revised to identify the appropriate sections with greater specificity,"

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[17] 12 CFR 34.24, which applies 12 CFR part 34, subpart B.

and the rule itself then designated four particular provisions.

Between publication of the proposed and final rules, OTS issued a legal opinion to address a particular state law on prepayment penalties.[18] The opinion concluded that the application of the Parity Act to a state prepayment provision fell into a gray area between laws clearly preempted by the Act (those barring variable rate loans) and those clearly not (those governing liens and foreclosures.) The opinion recognized that the OTS prepayment provisions applied to all real estate loans for federal thrifts not just alternative mortgage transactions, but then simply stated that state housing creditors would be "disadvantaged vis-a-vis federal thrifts" if they had to comply with the state law restricting prepayment penalties and so concluded that it was preempted.

The purpose of the Parity Act was to enable all housing creditors to provide credit with alternative mortgage vehicles and to preempt state laws that would prevent that type of credit.[19] The designation of § 560.35 and § 560.210 is essential to enable state housing creditors to continue to provide alternative mortgages. Accordingly, to provide parity with federal thrifts, OTS's proposed rule continues to designate these two provisions.

On the other hand, the OTS prepayment and late fee provisions are not intrinsic to the ability to offer alternative mortgages. We note that credit unions are barred by

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[18] OTS Op. Chief Counsel (April 30, 1996).

[19] It is of note that the Parity Act makes no reference to fees or penalties nor does it direct the federal regulators to consider their impact on alternative mortgages.

statute from imposing prepayment penalties on any loan, while OCC has specifically designated a prepayment penalty provision as applying to alternative mortgages. As for late fees, NCUA has designated its late fee provision as applying, while OCC has not. As these various approaches illustrate, the agencies have exercised broad discretion in their designations of appropriate regulations under the Parity Act and have struck different balances depending upon their statutory and regulatory scheme.

Certainly there are advantages and disadvantages to each charter and licensing scheme for the various types of housing creditors. Federal thrifts operate under a uniform system of safety and soundness and compliance rules nationwide, with regular examinations and close supervision. State thrifts have a somewhat similar system governing operations within their own jurisdictions. Other types of housing creditors are not bound by these restrictions and have more latitude in their operations.

OTS is proposing to delete § 560.34 and § 560.33 from the list of regulations designated for alternative mortgages. These two regulations apply to real estate loans in general and are part of a broader regulatory scheme governing the lending operations for federal thrifts.

OTS recognizes that state housing creditors may view this proposal as having a discriminatory impact on their ability to offer alternative mortgages. States that restrict prepayment penalties and late fees generally apply those restrictions to all real estate loans, not just to alternative mortgage transactions. The states' laws in these areas are not directed at restricting alternative mortgage transactions but in regulating mortgage transactions in general.

One of the congressional findings underlying the Parity Act was that OTS and the other federal regulators had adopted regulations authorizing their federally chartered institutions to offer alternative mortgages, and that the purpose of the Act was to eliminate the discriminatory impact of those regulations.[20] OTS regulations on prepayment penalties and late fees, however, were not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts the flexibility to exercise their lending powers under a uniform federal scheme. *See* 12 CFR 560.2(a). Therefore, OTS does not believe that Congress intended that regulations such as these would offer a basis for claiming discriminatory treatment or were needed to provide parity with federally chartered institutions. Indeed, OTS broadly allows federal thrifts to impose loan-related fees (e.g., initial charges and servicing fees) on any loan including alternative mortgages, notwithstanding any state law to the contrary. OTS also allows federal thrifts to process and originate any loan including alternative mortgages, without regard to state law. There is no basis for distinguishing prepayment penalties and late fees from these other OTS rules that apply generally to loans.

Accordingly, OTS proposes to delete the prepayment and late charge regulations from the list of regulations that apply to state housing creditors under the Parity Act. Under the proposed rule, OTS would identify only § 560.35 (adjustments to home loans) and § 560.210 (disclosures for variable rate transactions) as appropriate and applicable for state housing creditors.

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[20] 12 U.S.C. 3801(a)(3) and (b).

OTS solicits comments on all aspects of this proposal and specifically requests comments on the following questions:

1. Has OTS correctly identified the factors it must weigh in determining whether a specific rule should be designated as applicable for state housing creditors? If not, which factors should OTS consider?

2. Has OTS appropriately and fairly applied these factors? Should OTS add any other regulations to the proposed list of designated regulations? Should OTS delete any regulation from the proposed list?

3. The Parity Act requires OTS to designate regulations for state housing creditors that include both depository institutions (state-chartered savings associations) and non-depository institutions. By contrast, OCC and NCUA designations, like the underlying regulations themselves, apply only to depository institutions (*i.e.*, state chartered commercial banks and credit unions). Because state-chartered savings associations are subject to a safety and soundness regulatory scheme that is similar to that of federal thrifts and substantially different from other types of state-housing creditors, should OTS treat state-chartered savings associations differently under the Parity Act? Should OTS, for example, designate §§ 563.33 and 563.34 for state housing creditors that are depository institutions, but not for other types of state housing creditors? Does the Parity Act authorize OTS to differentiate between state housing creditors on this basis?

4. Sections 560.33 and 560.34 can be viewed as helping to promote safe and sound operations. For example, § 560.34 permits federal thrifts to moderate prepayment risk through the assessment of prepayment penalties; § 560.33 allows federal thrifts to encourage the timely payment of loans and to recover costs associated with late payments. In light of this, is it appropriate to apply these rules to state-chartered housing lenders that are depository institutions? Similarly, based on these safety and soundness considerations, should OTS apply these rules to all real estate loans made by state savings associations? What studies or empirical data exist to support the need to apply these rules to state savings associations?

C. Recommendations for Statutory Changes

The majority of consumer groups and some states commenting on the ANPR advocated that OTS recommend that Congress repeal the Parity Act. These commenters asserted that the Parity Act is no longer needed to circumvent state restrictions on adjustable rate mortgages since nearly all states now allow such transactions. These commenters contended that state housing creditors are now using the Parity Act to defeat states' attempts to impose reasonable consumer protection laws. Financial institutions addressing this issue generally opposed repeal of the Parity Act, because the Act enables financial institutions to offer uniform loan products across state lines, thereby lowering credit costs and increasing credit availability. These commenters contended that other federal laws exist to address predatory lending and consumer issues.

Legislative actions affecting the Parity Act are, of course, beyond the scope of this rulemaking. OTS believes, however, that Congress should revisit the Parity Act, possibly in the context of broader mortgage reform legislation involving the Real Estate Settlement Procedures Act (RESPA),[21] the Home Ownership and Equity Protection Act (HOEPA),[22] or predatory lending. In contrast to the situation in the late 1970s and early 1980s, state regulators tell us that all states but one currently allow alternative mortgage transactions. If Congress believes that alternative mortgage transactions merit special treatment, it may want to consider whether it should enact a statute that applies equally to all entities providing alternative mortgage transactions, along the model of Regulation Z.

OTS has two additional recommendations in the event of Congressional review of the Parity Act. First, if the Act remains in place, states should be permitted another opportunity to opt out of the preemption provided by the Parity Act.[23] Congress originally gave the states a choice to opt out of the preemption provision so that housing creditors in that state would be bound by the state's regulations with respect to alternative mortgage transactions. Initially, the states had three years from the effective date of the Parity Act, from 1982 to 1985, to opt out of the preemption provisions. At the time, only a handful of states decided to reject preemption. However, today, with credit more readily available, the acceptance of alternative

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[21] Pub. L. No. 93-533, § 2, (1974), 88 Stat. 1724, 12 U.S.C. 2601 *et seq.*

[22] Pub. L. No. 103-325 (1994), 108 Stat. 2160, amending the Truth in Lending Act, 15 U.S.C. 1601 *et seq.*

[23] 12 U.S.C. 3804(a).

mortgage transactions by the states, and the rising incidence of potentially predatory lending practices, additional states might possibly elect to opt out of the Parity Act if given the opportunity.

Second, OTS recommends that state housing creditors lending under the authority of the Parity Act be required to identify themselves to the states. Currently, although the Parity Act provides the states with a mechanism to remove its preemption benefits from certain housing creditors, it is difficult for the states to do so without a reliable means of knowing who is a Parity Act creditor. Housing creditors may enjoy preemption benefits on alternative mortgage transactions only if those transactions are in substantial compliance with applicable federal regulations and the creditor timely cures any error. Loans made under the aegis of the Parity Act lose the benefit of preemption and therefore must comply with state law if the housing creditor fails to cure any error within sixty days of discovery. The recommended notification provision would permit the states to better monitor the housing creditors taking advantage of the Parity Act preemption benefits and those in particular that fail to timely cure any errors.

II. Preemption of State Usury Law (12 CFR Part 590) – Late Fees on Federally-Related Residential Manufactured Housing Loans

Part 590 implements section 501 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) (12 U.S.C. 1735f-7a),[24] which provides for

[24] Pub. L. 96-221, 94 Stat. 161 (1980).

the permanent preemption of state laws expressly limiting the rate or amount of interest, discount points, finance charges, or other charges assessed in connection with certain "federally-related" residential loans.[25]

This preemption does not apply to loans secured by a first lien on a residential manufactured home unless the terms and conditions of the loan comply with consumer protections provisions specified in OTS regulations at 12 CFR 590.4. These regulations address such matters as balloon payments, prepayment penalties, late charges, deferral fees, notice before repossession or foreclosure, and the refund of prepaid interest. Section 590.4(f) specifically addresses late charges. Among other requirements, this paragraph states: "To the extent that applicable state law does not provide for a lower charge * * * a late charge on any installment * * * may not exceed the lesser of $5.00 or five percent of the unpaid amount of the installment."

Thus, unless the installment on a manufactured housing loan is less than $100, OTS's rule permits a maximum $5.00 fee for late payments on such loans. Over the years, OTS has received requests from representatives of manufactured housing lenders seeking the revision of this provision. These lenders argue that the $5 amount is too small to deter late payments. They assert that the absence of a tangible penalty has contributed to a run-up of delinquencies and repossessions, and to increases to their costs of funds. Accordingly, these lenders have sought the deletion of the $5.00 limit.

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[25] Loans are "federally-related" if the originator meets certain lender criteria, or the loan is classified as a federal agency loan, a federal housing program loan, or a loan eligible for purchase by government sponsored enterprises. *See* 12 CFR 590.2(b).

In today's rule, OTS is proposing to eliminate the $5.00 limit. Under the proposed rule, the late fee would be limited to five percent of the unpaid amount of the installment, unless applicable state law imposes a lesser charge. OTS specifically requests comment whether this five percent limitation should also be deleted from the final rule.

III. Preemption of State Due-on-Sale Laws (12 CFR Part 591) – Definition of Reverse Mortgage

OTS regulations at 12 CFR 591 implement section 341 of the Garn St Germain Depository Institutions Act of 1982 (12 U.S.C.A. 1701j-3).[26] This part governs the permissibility of due-on-sale clauses in real estate loans and the preemption of state prohibitions on such clauses.

OTS is proposing a minor technical change to the definition of reverse mortgage at 12 CFR 591.2(n). The rule would clarify that a reverse mortgage is not limited to a loan that provides for periodic payments, but also includes a loan that provides for a lump sum payment. This change is consistent with OTS legal opinions.[27]

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[26] Pub. L. 97-320, 96 Stat. 1469 (1982).

[27] OTS Op. Chief Counsel (June 2, 2000) (reverse mortgage loans include those providing for a lump sum payment).

IV. Solicitation of Comments Regarding the Use of Plain Language

Section 722 of the Gramm-Leach Bliley Act[28] requires federal banking agencies to use "plain language" in all proposed and final rules published after January 1, 2000. OTS invites comments on how to make this proposed rule easier to understand. For example:

(1) Have we organized the material to suit your needs? If not, how could the material be better organized?

(2) Do we clearly state the requirements in the rule? If not, how could the rule be more clearly stated?

(3) Does the rule contain technical language or jargon that is not clear? If so, what language requires clarification?

(4) Would a different format (grouping and order of sections, use of headings, paragraphing) make the rule easier to understand? If so, what changes to the format would make the rule easier to understand?

V. Executive Order 12866

The Director of OTS has determined that this proposed rule does not constitute a "significant regulatory action" for purposes of Executive Order 12866.

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[28] 12 U.S.C. 4809.

VI. Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (Unfunded Mandates Act), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in expenditure by state, local, and tribal governments, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, Section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. OTS has determined that the proposed rule will not result in expenditures by state, local, or tribal governments or by the private sector of $100 million or more. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995.

VII. Regulatory Flexibility Act

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) requires the agency to "prepare and make available for public comment an initial regulatory flexibility analysis" which will "describe the impact of the proposed rule on small entities." 5 U.S.C. § 603(a). Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the proposed rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

Parts 590 and 591. OTS has not prepared an initial regulatory flexibility analysis (IRFA) for the proposed revisions to part 590 and part 591. The proposed change to part 590 affects creditors making federally-related loans

secured by first liens on residential manufactured housing. The proposed change would provide these creditors with greater flexibility in charging late fees, while retaining the benefits of preemption of state usury laws under section 501 of DIDMCA. The current rule permits a limited late fee of $5, which has proven to be too small to deter late payments. The proposed change permitting the imposition of a more tangible penalty will benefit all creditors making such loans, including small businesses. Part 591 permits all lenders, whether federally- or state-chartered, to exercise due-on-sale clauses in real property loans without regard to state law. OTS proposes a clarifying change broadening the definition of reverse mortgage. Since this change codifies an existing OTS interpretation of the term which broadens the availability of preemption under part 591, any impact on lenders should be beneficial. Accordingly, OTS certifies to the Chief Counsel of Advocacy of the Small Business Administration that the proposed changes to parts 590 and 591 will not have a significant economic impact on a substantial number of small entities.

Section 560.210. OTS has performed an IRFA for the proposed changes to § 560.210.[29] A description of the

[29] OTS questions whether an IRFA is required. The RFA does not require an agency to analyze the effects of a rule on entities that it does not regulate. *See American Trucking Association, Inc. v. EPA*, 175 F.3d 1027 (D.C. Cir. 1999) (The D.C. circuit held that EPA was not required to perform a RFA for its national ambient air quality standards (NAAQS). The NAAQS themselves imposed no regulations on small entities. Instead, the several states regulated small entities through the state implementation plans that they were required to develop under the Clean Air Act. Because the NAASQ regulated small entities only indirectly – that is, insofar as they affected the planning decisions of the states – the EPA concluded, and the D.C. circuit agreed, that small entities were not subject to the rule.)

(Continued on following page)

reasons why OTS is considering the proposed change and a statement of the objectives of, and legal basis for, this aspect of the proposed rule are included in the supplementary material above. In addition, OTS has addressed the following topics.

A. Small entities to which the proposed rule would apply

The proposed change to § 560.220 would apply to state housing creditors other than credit unions or commercial banks. OTS does not compile data on the total number of state housing creditors that may utilize § 560.220. Moreover, except for state-chartered savings associations, OTS does not have any authority to require state housing creditors to identify themselves or submit other data to OTS. Similarly, the Parity Act does not require state housing creditors to notify the states that they are taking advantage of the Act. As a result, OTS has little information regarding how many state housing creditors may use § 560.220 or how many of these creditors are small businesses.

Nonetheless, OTS estimates that 6,386 small state housing creditors may be affected by this regulation. United States Census data indicates that 7,257 firms (excluding depository institutions) engage in real estate credit. OTS estimates approximately 6,300 of these firms

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As revised, § 560.210 imposes no restrictions or limitations on any small entity's ability to impose prepayment penalties or late charges. Rather, the proposed OTS rule would leave the regulation of these matters entirely to the discretion of the individual states. As a result, OTS believes that it may certify that the rule will not have a significant impact on a substantial number of small entities.

are small businesses.[30] Based on the most recent TFR data for thrifts, OTS estimates that an additional 86 state-chartered savings associations are small businesses.[31] For the purposes of this analysis, we have assumed that all 6,386 of these small businesses engage in alternative mortgage transactions.

OTS believes that this number may overstate the number of small businesses that may be affected by the changes to the proposed rule for several reasons. First, the use of the Parity Act is solely at the election of the state housing creditors. State housing creditors may, for whatever reason, decline to use the Parity Act for their alternative mortgage transactions. Moreover, many small state housing creditors will conduct alternative mortgage transactions that are governed by laws in states that either:

- Opted out of the Parity Act. State housing creditors conducting alternative mortgage transactions governed by these laws currently cannot use § 560.220 to preempt state law; or

- Enacted statutes that do not impose any substantive prohibitions and restriction on prepayment penalties or late charges for the loans.

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[30] OTS based this figure on firms engaged in real estate credit and reported under NAICS 522292. A firm engaged in real estate credit is considered to be small if it has total receipts of $5 million or less per year. 13 CFR 121.201. OTS has used the special tabulation of the 1997 economic census from the United States Bureau of the Census to determine the number of these firms and their annual receipts.

[31] Based on December 2001 TFR data, OTS regulates 138 state savings associations. Of these savings associations, 86 have assets of $100 million or less. Small depository institutions are generally defined, for RFA purposes, as those with assets under $100 million. *See* 13 CFR 121.201.

> State housing creditors may continue to charge penalties and fees on alternative mortgage transactions in these states, notwithstanding the proposed changes to § 560.220.

OTS's estimate of 6,386 small businesses is based on the best information available to it. However, OTS encourages any commenter with access to more complete and more accurate data to submit information regarding the number of state housing creditors (other than credit unions or commercial banks) that may be affected by this rule. OTS also requests information regarding how many of these creditors that may be small businesses.

B. Requirements of the Proposed Rule

The Parity Act permits certain state housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law or regulation, provided that they comply with regulations designated by OTS. As described more fully in the supplementary information section, the proposed rule would revise OTS's designation of applicable regulations so that it would no longer designate rules on prepayment and late charges. As a result, these state housing creditors would be subject to state laws limiting prepayment penalties and restricting late charges.

OTS is unable to quantify the impact of the proposed revision on small state housing creditors for several reasons. Based on available data, it is difficult to determine how many alternative mortgage transactions were made under the OTS Parity Act regulations. Industry-wide data is available only for one type of alternative mortgage transaction – adjustable rate mortgages (ARMs). Other

types of mortgages with alternative features are generally reported as fixed rate mortgages. The available data, however, indicates that all housing lenders originated $243.6 billion and $256 billion in ARMs in 2001 and 2000 respectively.[32] The most recent data available indicated that state housing creditors (excluding commercial banks and thrifts) account for approximately 56.3 percent of all lending or $137.1 billion and $144.1 billion of ARMs in 2001 and 2000.[33] OTS estimates that $14.7 billion and $15.4 billion of these ARM loans were originated by small state housing creditors in 2001 and 2000.[34] This available data, however, does not distinguish between transactions that are made under the Parity Act, and those that are not. As noted above, OTS has no authority to require state housing creditors that use § 560.220 to provide this information.[35]

In the ANPR, OTS attempted to obtain additional information on the extent to which state housing creditors

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[32] Mortgage Bankers Association website at www.mbaa.org indicates that the industry originated $2,030 billion in 1-to 4-family mortgages in 2001, and $1,024 billion of these loans in 2000, and that 12% and 25% of these loans were ARMs in 2001 and 2000.

[33] This information was also obtained on the Mortgage Bankers' Association's website, which indicates that its source was a HUD Survey of Mortgage Lending Activity discontinued in 1998. This data applies to all lending and is based on 1997.

[34] OTS computed this figure using receipts by real estate creditors as proxy for originations. Based on these figures, OTS estimates that small creditors accounted for 10.7% of all ARM originations by real estate creditors.

[35] OTS does not currently collect data on the ARM originations by the 86 small state savings associations. However, 2000 CMR data indicates that these 86 thrifts hold approximately $815 million of ARMs in their portfolios. Again, this data does not distinguish transactions subject to the Parity Act regulations.

engage in alternative mortgage transactions under the Parity Act. Commenters, however, provided no reliable information on this subject.[36] Nonetheless, OTS encourages any commenter with access to more complete and more accurate data to submit information regarding the extent to which small state housing creditors engage in alternative mortgage lending under § 560.220.

OTS further requests information concerning the amount of late fees and prepayment penalties generated by these alternative mortgage transactions. OTS notes, however, that reliable estimates of the amount of late fees and prepayment penalties would not accurately reflect the impact of the deletion of the preemption of prepayment charge provisions and late charge provisions. The 6,386 small state creditors that may be affected by the proposed rule would become subject to a broad range of state laws. For example, some of these laws would continue to permit the imposition of prepayment penalties. Others may prohibit or restrict prepayment charges. Still other laws would subject prepayment penalties to a range of restrictions, such as prohibiting penalties for a set period after execution of the note or mortgage or limiting the amount of the prepayment penalty. Based on this wide variety of restrictions and the fact that current state laws will

[36] Specifically, OTS asked for information regarding predatory or abusive lending practices that would be contrary to State law but for the Parity Act. One of the commenters, a trade association representing a substantial segment of the real estate financing community, including national and regional lenders, mortgage brokers, mortgage conduits, and service providers stated that it "does not have specific numbers regarding the extent to which lenders are using the Parity Act to craft alternative mortgage products that would otherwise be affected by state law. Furthermore [it] knows of no reliable and comprehensive industry data from any source."

change over time, it is difficult to estimate how much of the income would be lost by small state housing creditors under the proposed rule.[37]

Moreover, the impact of the loss of prepayment penalties may be ameliorated somewhat through other techniques. For example, lenders often impose a higher overall interest rate where prepayment penalties are excluded from the loan agreement.[38] In addition, some commentators assert that the payment of points upon origination and the imposition of a prepayment penalty are economically equivalent transactions. Since a mortgage with points includes an implicit and easily calculable prepayment penalty, state housing creditors may substitute points where prepayment penalties are prohibited.[39]

OTS requests information quantifying the impact that the proposed revision will have on small state housing creditors.

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[37] *See* "The Handbook of Mortgage-Backed Securities," 88-101 (Frank J. Fabozzi, ed. (5th ed. 2001)), which contains a compilation of current state laws on prepayment penalties.

[38] In April 2000, one large subprime lender indicated that it lowered the interest rate on a loan by 75 basis points for those borrowers who accepted a prepayment penalty. See Joint HUD/Treasury Report on Recommendations to Curb Predatory Home Mortgage Lending (April 2000), citing information from the New Century Mortgage Corporation website, www.newcentury.com.

[39] Alan L. Feld & Stephan G. Marks, Legal Differences Without Economic Distinctions: Points, Penalties, and the Market for Mortgages, 77 B.U.L. Rev 405 (1977).

C. Significant Alternatives

Section 603(c) of the RFA requires OTS to describe any significant alternatives to the proposed rule that accomplish the stated objectives of the rule while minimizing any significant economic impact of the rule on small entities. Section 603(c) lists several examples of significant alternatives, including: (1) Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) clarifying, consolidating, or simplifying compliance and reporting requirements for small entities; (3) using performance standards rather than design standards; and (4) excepting [sic] small entities from coverage of the rule or a part of the rule.

OTS considered retaining its current designation of regulations for all state housing creditors. For the reasons noted in the preamble above, OTS believes that this course is inappropriate. OTS also considered whether it should continue to designate the existing regulations for small state housing creditors, but not for other state housing creditors. However, given its analysis of the purposes and goals of the Parity Act, OTS has concluded that it is inappropriate to distinguish between small and large state housing creditors. OTS solicits comment from any other alternatives that would minimize the burdens on small state housing creditors.

D. Other Matters

Various federal rules or statutes duplicate or overlap with the proposed rule. NCUA has identified all of its lending regulations as applicable to alternative mortgage transactions by state-chartered credit unions. 12 CFR

701.21(a). These regulations address such matters as the term of the loan, requirements governing security instruments, notes, liens, due-on-sale provisions, and assumptions and, as required under the Federal Credit Union Act, specifically prohibit prepayment penalties. OCC, on the other hand, had designated as applicable to state-chartered commercial banks, its rules that directly relate to adjustable rate mortgages. OCC's designated regulations define ARM loans, authorize certain indexes, and allow prepayment fees. 12 CFR 34.24. In addition, other federal statutes and rules may preempt the application of state laws on prepayment penalties and late fees for alternative mortgage transactions by state housing creditors. *See e.g.*, 12 CFR part 590 (preemption of state usury laws under section 501 of DIDMCA) and 12 CFR part 591 (preemption of state due on sale clauses under section 341 of Garn St Germain Depository Institutions Act of 1982).

OTS is aware of no federal rules or statutes that conflict with the proposed rule.

VIII. Federalism

Executive Order 13132 imposes certain requirements on an agency when formulating and implementing policies that have federalism implications or taking actions that preempt state law. In accordance with those requirements, OTS has consulted with the Conference of State Bank Supervisors and the National Association of Attorneys General concerning this proposed change.

List of Subjects

12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 590

Banks, Banking, Loan programs – housing and community development, Manufactured homes, Mortgages, Savings associations.

12 CFR Part 591

Banks, Banking, Loan programs – housing and community development, Mortgages, Savings associations.

Accordingly, the Office of Thrift Supervision proposes to amend 12 CFR parts 560, 590, and 591 as set forth below:

PART 560 – LENDING AND INVESTMENTS

1. The authority citation for part 560 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1701j-3, 1828, 3801, 3802, 3803, 3806; 42 U.S.C. 4106.

2. Revise § 560.220 to read as follows:

§ 560.220 Alternative Mortgage Transactions Parity Act.

(a) *Applicable housing creditors.* A housing creditor that is not a commercial bank, a credit union, or a Federal savings association may make alternative mortgage

transactions by following the regulations identified in paragraph (b) of this section, notwithstanding any state constitution, law, or regulation. *See* 12 U.S.C. 3803.

(b) *Applicable regulations.* OTS designates §§ 560.35 and 560.210 as appropriate and applicable for state housing creditors. All other OTS regulations are not identified, and are inappropriate and inapplicable to state housing creditors. State housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable in applying these regulations.

PART 590 – PREEMPTION OF STATE USURY LAWS

3. The authority citation for part 590 continues to read as follows:

Authority: 12 U.S.C. 1735f-7a.

4. Revise the section heading and paragraph (f)(4) in § 590.4 to read as follows:

§ 590.4 Federally-related residential manufactured housing loans – consumer protection provisions.

* * *

(f) * * *

(4) To the extent that applicable state law does not provide for a lower charge or a longer grace period, a late charge on any installment not paid in full on or before the 15th day after its scheduled or deferred due date may not exceed five percent of the unpaid amount of the installment.

* * *

PART 591 – PREEMPTION OF STATE DUE-ON-SALE LAWS

5. The authority citation for part 591 continues to read as follows:

Authority: 12 U.S.C. 1464 and 1701j-3.

6. Revise § 591.2(n) to read as follows

§ 591.2 Definitions.

* * *

(n) *Reverse mortgage* means an instrument that provides for one or more payments to a homeowner based on accumulated equity. The lender may make payment directly, through the purchase of annuity through an insurance company, or in any other manner. The loan may be due either on a specific date or when a specified event occurs, such as the sale of the property or the death of the borrower.

* * *

By the Office of Thrift Supervision.

James E. Gilleran,

Director.

[FR Doc. 02-10126 Filed 4-24-02; 8:45 am]

BILLING CODE 6720-01-P

67 Fed. Reg. 60,542 (Sept. 26, 2002)

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 560, 590, and 591

[No. 2002-43]

RIN 1550-AB51

Alternative Mortgage Transaction Parity Act; Preemption

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule.

SUMMARY: The Alternative Mortgage Transaction Parity Act (AMTPA) authorizes state chartered housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation. To rely on AMTPA, certain state chartered housing creditors must comply with regulations on alternative mortgage transactions issued by the Office of Thrift Supervision (OTS). In today's rulemaking, OTS revises its rules identifying the OTS regulations that apply under AMTPA. OTS will no longer identify its regulations on prepayments and late charges for state chartered housing creditors.

OTS is also revising its limits on the amount of late charges that may be assessed on loans secured by first liens on residential manufactured homes under part 590, which addresses the preemption of state usury laws. In addition, OTS is making a minor technical change to the

definition of reverse mortgage in part 591, which addresses the preemption of state due-on-sale laws.

EFFECTIVE DATE: January 1, 2003.

FOR FURTHER INFORMATION CONTACT:
Theresa Stark, Senior Project Manager, Compliance Policy, (202) 906-7054; Karen Osterloh, Special Counsel, Regulations and Legislation Division, (202) 906-6639, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Alternative Mortgage Transaction Parity Act Regulations (§ 560.220)

The Alternative Mortgage Transaction Parity Act (AMTPA)[1] permits state chartered housing creditors[2] to make, purchase, and enforce alternative mortgage transactions if the creditors comply with regulations governing such transactions issued by federal regulators. AMTPA applies to loans with any alternative payment features that vary from conventional fixed-rate, fixed-term mortgage loans, such as variable rates, balloon payments, or call features. It allows state chartered housing creditors to

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[1] 12 U.S.C. 3801 *et seq.*

[2] A "housing creditor" is a depository institution, a lender approved by the Secretary of Housing and Urban Development for participation in certain mortgage insurance programs, "any person who regularly makes loans, credit sales or advances secured by interests in properties referred to in [AMTPA]; or * * * any transferee of any of them." To qualify as a state housing creditor and take advantage of preemption, AMTPA specifically provides that the creditor must be "licensed under applicable State law and [remain or become] subject to the applicable regulatory requirements and enforcement mechanisms provided by State law." 12 U.S.C. 3802(2).

engage in alternative mortgage transactions notwithstanding "any State constitution, law, or regulation," provided the transactions are made in conformity with regulations issued by one of three federal regulators.[3] Housing creditors, other than state chartered commercial banks and state chartered credit unions, that wish to make an alternative mortgage transaction under the authority of AMTPA, must comply with OTS regulations. State chartered commercial banks and state chartered credit unions must comply with regulations of the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration (NCUA), respectively.[4]

AMTPA directed the Federal Home Loan Bank Board (Bank Board), OTS's predecessor agency, OCC, and NCUA to identify, describe, and publish those portions of their regulations that are inappropriate for, and thus inapplicable to, their respective state chartered housing creditors.[5] The identified regulations are enforced by each state housing creditor's applicable state regulator.

Currently, OTS's regulation at § 560.220 identifies the following regulations as appropriate for, and applicable to, state housing creditors:

- § 560.33. This reference permits state housing creditors to impose late charges for any delinquent periodic payment and sets out certain limitations on the assessment of such late charges.

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[3] 12 U.S.C. 3803(c).

[4] 12 U.S.C. 3803(a).

[5] Section 807(b) of Pub. L. 97-320 (1982).

- § 560.34. This reference permits state housing creditors to impose a prepayment penalty and indicates how prepayments must be applied.

- § 560.35. This section addresses adjustments to interest rate, adjustments to the payment and loan balance, and the use of indices.

- § 560.210. This reference requires state housing creditors to provide initial disclosures and adjustment notices for variable rate transactions.

Housing creditors must comply with these requirements to obtain the benefit of AMTPA's preemption of state laws. All other OTS regulations are inappropriate and inapplicable to state housing creditors.

On April 5, 2000, OTS published an advance notice of proposed rulemaking (ANPR) entitled "Responsible Alternative Mortgage Lending."[6] The ANPR sought public comment on various questions in connection with a review of mortgage lending regulations, including comments on possible amendments to § 560.220.

On April 25, 2002, OTS issued a notice of proposed rulemaking (NPRM).[7] OTS proposed to delete the late charge and prepayment rules (§§ 560.33 and 560.34) from the list of regulations that apply to state housing creditors under AMTPA. OTS proposed to continue to identify the other two rules (§§ 560.35 and 560.210) as appropriate and applicable for state housing creditors.

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[6] 65 FR 17811 (Apr. 5, 2000).

[7] 67 FR 20468 (Apr. 25, 2002).

OTS received 298 comments on the proposed rule and 293 of these commenters addressed changes to AMTPA provisions. The commenters were equally divided between support and opposition for the rule. About three-quarters of the commenters filed one of five form letters.

A. OTS Authority Under AMTPA

1. Background

Congress enacted AMTPA in 1982 to stimulate credit in an unusually high interest rate environment by encouraging variable rate mortgages and other creative financing. In hearings before the Senate in 1981, mortgage bankers testified that statutes in 26 states barred state chartered mortgage bankers and lending institutions from originating alternative mortgage loans, or imposed significantly higher restrictions on such loans than applied to federally chartered lenders operating under federal regulations.

Congress incorporated this factual background at 12 U.S.C. 3801(a). Congress found that increasingly volatile and dynamic changes in interest rates had seriously impaired the ability of housing creditors to provide consumers with fixed-term, fixed-rate credit secured by interests in real property, and that alternative mortgage transactions were essential to an adequate supply of credit. AMTPA also noted that OCC, NCUA, and OTS had recognized the importance of alternative mortgage transactions and had adopted "regulations authorizing federally chartered depository institutions to engage in alternative mortgage financing." AMTPA indicated that:

> It is the purpose of this chapter to eliminate the discriminatory impact that those regulations

> have upon nonfederally chartered housing creditors and provide them with parity with federally chartered institutions by authorizing all housing creditors to make, purchase, and enforce alternative mortgage transactions so long as the transactions are in conformity with the regulations issued by the Federal agencies. 12 U.S.C. 3801(b).

Section 3803(a) states that state housing creditors may comply with regulations governing alternative mortgage transactions issued by NCUA, OCC, or OTS. Section 807(b) of AMTPA directs the three federal regulators to identify, describe, and publish those portions or provisions of their respective regulations that are "inappropriate for (and thus inapplicable to)" nonfederally chartered housing creditors.

Apart from references to federal regulations governing alternative mortgage transactions and regulations authorizing federally chartered lenders to engage in alternative mortgage transactions, neither the statute nor the legislative history details how the three federal agencies are to exercise their authority under section 807(b). For example, AMTPA and the legislative history do not reference or provide examples of specific types of regulations that the agencies should identify for state housing creditors.

As a result of this inconclusive direction, OTS and the Bank Board have wrestled with the proper scope of the identification of regulations for state housing creditors under AMTPA. At times, the agency has taken a narrow view of AMTPA and its legislative history. For example, the Bank Board initially identified as appropriate and applicable only those regulations that "describe and define" alternative mortgage transactions and did not

identify regulations intended for the general supervision of federal savings associations. As a result, the Bank Board declined to identify rules that applied to loans generally (as distinguished from rules that bear directly on the unique features of alternative mortgage loans).[8]

In 1996, however, OTS reviewed its AMTPA authority and identified two general lending rules – the prepayment and late charge provisions at issue in this rulemaking.[9] The apparent rationale, contained in a contemporaneous legal opinion, but not in the rulemaking, was the conclusion that state housing creditors would be "disadvantaged vis-à-vis federal thrifts" if they were required to comply with state laws restricting prepayment penalties and late charges.[10] Even the contemporaneous legal opinion, however, conceded that the state laws on these subjects fell somewhere between laws clearly preempted by AMTPA (state laws barring variable rate mortgage loan transactions) and laws clearly not preempted (state laws governing liens and foreclosures).

NCUA and OCC regulations also reflect various interpretations of the scope of section 807(b) of AMTPA. NCUA has interpreted section 807(b) to permit the identification of all of its lending regulations as applicable to alternative mortgage transactions by state chartered credit unions. These mortgage regulations address such matters as the term of the loan; requirements governing security instruments, notes, and liens; due-on-sale provisions; and

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[8] 47 FR 51732 (Nov. 17, 1982) and 48 FR 23032, 23053 (May 23, 1983).

[9] 61 FR 50951 (Sept. 30, 1996).

[10] OTS Op. Chief Counsel (Apr. 30, 1996).

assumptions. NCUA rules specifically preempt state laws addressing certain areas. 12 CFR 701.21. OCC, on the other hand, has identified as applicable for state commercial banks a narrow band of rules. These rules: define adjustable rate mortgages (ARMs); state that ARMS may be made, sold, purchased, participated in, or otherwise dealt in without regard to any state law limitation on those activities; authorize certain indices; and specifically allow prepayment fees. 12 CFR part 34, subpart B.

As these various approaches illustrate, section 807(b) is susceptible to a number of interpretations. Each of the agencies has exercised broad discretion in its identification of appropriate regulations under AMTPA and has struck a different balance depending on its applicable statutory and regulatory scheme. Under the current rules, each of the three agencies has advanced a different interpretation of its responsibilities under section 807(b) of AMTPA.

2. OTS's Approach

In the NPRM, OTS reexamined its 1996 interpretation. OTS noted that the purpose of AMTPA was to enable all housing creditors to provide credit through alternative mortgages and to preempt state laws that would prevent that type of credit. OTS found that its regulations governing adjustments to the interest rate, adjustments to the payment and loan balance, the use of indices, initial disclosures, and adjustment notices were essential or intrinsic to the ability of state housing creditors to continue to provide alternative mortgage transactions. To provide parity with federal thrifts, OTS proposed to continue to identify §§ 560.35 and 560.210 for state housing creditors.

On the other hand, OTS tentatively noted, upon further reflection, that the prepayment and late fee provisions were not essential or intrinsic to the ability to offer alternative mortgages. Rather, these regulations apply to real estate lending in general and are part of the broader regulatory scheme governing the lending operations of thrifts. OTS noted that one of the congressional findings underlying AMTPA was that the various federal regulators had adopted regulations authorizing federal institutions to offer alternative mortgages, and that the purpose of AMTPA was to eliminate the discriminatory impact of those regulations. OTS tentatively found that its regulations on prepayments and late fees were not adopted to enable federal thrifts to engage in alternative mortgage financing, but rather to permit federal thrifts to operate safely and soundly under a uniform federal scheme. *See* 12 CFR 560.2(a). Therefore, OTS tentatively concluded that these regulations did not offer a basis for claiming discriminatory treatment or were not needed to provide parity with federally chartered institutions. Accordingly, OTS tentatively concluded that there was no basis to distinguish prepayment and late charge provisions from other general lending rules and proposed to delete the two provisions from the list of identified rules for state housing creditors. As we explain in this statement of supplementary information, after reviewing the comments and further considering the issues, OTS adopts these findings and conclusions.

3. Comments on OTS's Approach

Several commenters argued that if AMTPA is to be given its proper effect, state housing creditors should be governed by the same regulations that address alternative

mortgage transactions by federal savings associations. According to commenters, these rules include § 560.2(a), which states OTS's intent to occupy the entire field of lending regulation for federal savings associations in preemption of state law, and § 560.2(b), which expressly preempts state laws that address such matters as private mortgage insurance requirements, loan-to-value ratios, terms of credit, loan-related fees (including late charges and prepayment penalties), access to credit reports, disclosures, and advertising laws.

OTS has never identified its preemption rules as applicable to state housing creditors under AMTPA. While commenters argued that the failure to apply these preemptive regulations would disadvantage state housing creditors vis-à-vis federal thrifts, OTS believes that this position would lead to an inappropriate result under its regulatory framework.

To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices, OTS has occupied the entire field of lending regulation for federal thrifts and has given federal savings associations the maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme. *See* 12 CFR 560.2(a). This complex uniform regulatory scheme benefits federal thrifts by preempting most state laws that otherwise would impose on federal savings associations different regulatory requirements from state-to-state. The system, however, also imposes various obligations on federal savings associations. For example, thrifts must comply with an array of regulatory limitations designed to ensure that their mortgage lending operations are conducted in a safe and sound manner. These limitations

include appraisal requirements, real estate lending standards, underwriting guidelines, limits on loans to one borrower, and documentation requirements. Thrifts are also subject to regular examination, supervision, and enforcement of their lending activities.

OTS does not believe that it may impose these concomitant obligations on state housing creditors in this rulemaking given the instructions in the legislative history that it was not Congress' intent to place state housing creditors under the supervision of the federal agencies.[11] However, preemption under § 560.2, without the application of the related duties, would lead to an unreasonable regulatory result, *i.e.*, the perverse situation where state housing creditors could engage in mortgage lending – an area that is traditionally highly regulated – unfettered by most state or federal restrictions, thereby creating a regulatory vacuum. Accordingly, OTS declines to identify its preemption rules as applicable to state housing creditors.

Other general lending rules, such as §§ 560.33 and 560.34, are also a part of the broader regulatory scheme governing OTS supervision of the lending operations of federal thrifts. The states have, to a greater or lesser degree, adopted laws and regulations similarly designed to supervise the lending operations of state housing

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[11] Sen. Rep. 97-463, at 55 (1982). This interpretation is also contrary to other expressions of congressional intent, which left room for state action by specifically reserving specific areas to the states. 12 U.S.C. 3802(2), for example, indicates that state housing creditors must comply with applicable state licensing requirements and must remain or become subject to the applicable regulatory requirements and enforcement mechanisms provided by state law.

creditors. States that restrict prepayment penalties and late charges usually apply those restrictions to all real estate loans, not just to alternative mortgage transactions. As a result, the state laws in these areas are not directed at restricting alternative mortgage transactions, but in regulating mortgage transactions in general. OTS is reluctant to encroach upon this state authority, given the cited statutory direction and the statements of legislative intent.

For these reasons, OTS declines to identify its rules preempting state lending regulations or any other rule that applies to real estate lending in general. Rather, OTS will identify only those regulations that OTS deems to be intrinsic to the ability to offer alternative loans.[12]

A number of commenters alleged that this interpretation of AMTPA would subject state housing creditors to state laws on prepayments and late charges while federal thrifts would remain subject to more permissive OTS regulations in these areas. As a result, these commenters argued that the proposed rule is inconsistent with the twin purposes of AMTPA – the elimination of discriminatory impact that federal regulations have on state housing

[12] One commenter warned that this focus could undermine the broad preemption available for federal thrifts, *i.e.*, that state law may be preempted for federal thrifts only when preemption is "intrinsic" to the effectuation of a federal policy or goal. Other commenters sought assurance that the final rule would not erode or impair the scope of preemption available to, or the lending powers of, federal savings associations under the Home Owners' Loan Act (HOLA). This rule addresses OTS authority to identify rules for state housing creditors under AMTPA and has no impact on preemption available to, or the lending powers of, federal thrifts under the HOLA. The preemption principles under the HOLA are well settled. *See e.g.*, 12 CFR 545.2, 557.11, and 560.2; and OTS Op. Chief Counsel (Nov. 22, 1999).

creditors and the promotion of parity for state housing creditors. Specifically, commenters speculated that the proposed rule would discriminate against state housing creditors vis-à-vis federal savings associations in the following ways:

- Limit the range of products offered by state housing creditors. Some state housing creditors would no longer be able to offer lower rates to consumers who agree to take a loan with a prepayment penalty. In addition, restrictions on late charges would deny lenders flexibility in loan pricing and prohibit lenders from placing the cost of late payments on delinquent borrowers.

- Increase compliance costs, risk of document error, and litigation risk. Rather than complying with uniform OTS rules, creditors with multi-state operations would have to comply with inconsistent state and local laws.

- Reduce the ability to minimize prepayment risk. Prepayment penalties protect state housing creditors (and secondary market purchasers) from extreme changes in their portfolios.

- Reduce the value of their loans in the secondary market. Investors will be less able to protect against prepayment risk, and will incur additional due diligence costs (and risks) to review pools against widely varying state law. These costs will be passed on to state housing creditors. The secondary market also may have to create separate pools for federally chartered lenders and state chartered lenders to accommodate these differences.

Commenters also speculated that some lenders may choose not to offer alternative mortgage transactions in jurisdictions with restrictive laws, may cease all lending operations within those jurisdictions, or exit the industry entirely. This reduced competition, they argue, would reduce the availability of affordable credit to consumers contrary to the goals of AMTPA.

Contrary to commenters' speculation, historical evidence indicates that the final rule should not have a significant detrimental effect on state housing creditors' ability to compete against federal thrifts in the alternative mortgage market. State housing creditors functioned for 14 years (1982-1996) without applying OTS regulations on late charges and prepayments. While various prepayment regulations were applicable during this period, federal thrifts were relatively free to impose prepayment penalties since 1983.[13] Additionally, the regulations on late charges have not changed substantially during this period, other than to eliminate limitations on the amount of the late

[13] Until May 23, 1983, federal savings associations were permitted to impose prepayment penalties under limited circumstances. *See* 12 CFR 545.8-5(b) (1983) summarized below at note 19. On May 23, 1983, the Bank Board changed this rule to permit a federal savings association to impose prepayment penalties as provided in the loan contract. Penalties on loans secured by owner-occupied homes, however, were prohibited for a 90-day period following the issuance of a notice of adjustment of interest rate, payment balance, or term to maturity. 12 CFR 545.34(c) (1984). In 1993, OTS removed even these limited restrictions and allowed federal thrifts to impose prepayment penalties at any time and in any amount authorized in the loan contract for both adjustable rate and fixed rate loans. 58 FR 4308 (Jan. 14, 1993). This rule is now codified at 12 CFR 560.34 (2002).

charge.[14] Accordingly, OTS has concluded that these provisions are not essential for parity.

OTS also notes that state housing creditors were vigorous competitors in mortgage lending throughout this time period. While relative market share in the alternative mortgage market is not available, OTS does have information regarding the relative participation in the one- to four-family mortgage market. In 1982, commercial banks and thrifts dominated this market by originating approximately 66.0 percent of one- to four-family mortgages. Mortgage companies' market share was significantly smaller at 28.9 percent of the market. By 1996, when OTS changed its AMTPA rules, these positions had reversed with mortgage companies originating 56.8 percent and commercial banks and thrifts originating 42.5 percent of all one- to four-family mortgages.[15]

Moreover, it is not clear that Congress viewed prepayment penalties and late charges as essential to parity. Neither AMTPA nor its legislative history provides any useful guidance concerning this issue. However, if Congress had viewed these provisions as essential to parity, it is unlikely that Congress would have adopted the statutory scheme found in AMTPA. As noted above, AMTPA does not place all state housing creditors within the jurisdiction of one federal regulator, but assigns state housing creditors to three federal agencies in a way that

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[14] *Compare* 12 CFR 545.8-3(e) (1983) with 12 CFR 560.33 (2002).

[15] This information was obtained on the Mortgage Bankers' Association's Web site, which indicates that its source was a HUD Survey of Mortgage Lending Activity discontinued in 1998. OTS notes that at least one commenter asserts that state housing creditors now originate approximately 80 percent of all mortgages.

"recogniz[es] traditional industry lines."[16] When AMTPA was enacted, however, NCUA, OCC, and the Bank Board had different requirements regarding prepayment penalties. Congress banned federal credit unions from imposing prepayment penalties, which suggests that, at least for credit unions, Congress recognized that prepayment penalties were not essential to the ability to make, purchase, or enforce alternative mortgage transactions.[17] OCC regulations, on the other hand, permitted national banks to impose prepayment penalties on ARMs until 30 days prior to the first scheduled interest rate adjustment date.[18] Bank Board regulations permitted federal savings associations to impose prepayment penalties on alternative mortgage transactions under other limited circumstances.[19] If Congress had viewed the regulation of prepayment penalties as essential to parity, it is unlikely that Congress would have imposed a regulatory scheme that, at

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[16] Sen. Rep. 97-463, at 55 (1982).

[17] 12 U.S.C. 1757(5)(A)(viii) (1982).

[18] 12 CFR 29.6 (1983). Shortly after AMTPA was enacted, OCC revised this rule to permit prepayment fees without regard to the first scheduled interest rate adjustment. 48 FR 28970 (June 24, 1983).

[19] 12 CFR 545.8-5(b) (1983) provided: "a borrower on a loan secured by a home or combination of home and business property may prepay the loan without penalty unless the loan contract expressly provides for all of the following: (1) A prepayment penalty, (2) an interest rate that, after loan closing and after any interest-rate adjustment, remains fixed for a period of at least five years, and (3) only such increases in the loan balance as result from the deferral and capitalization of interest pursuant to § 545.6-2(a)(2)(iv) of this part. The prepayment penalty for a loan secured by a home or combination of home and business property shall not be more than six months' advance interest on that part of the aggregate amount of all prepayments made on such loan in any 12-month period which exceeds 20 percent of the original principal amount of the loan."

the time of enactment, ensured different treatment among the various state creditors.

The agencies also took different approaches to the regulation of late charges in 1982. The Bank Board limited the amount of late charges, prescribed a minimum grace period, and set other restrictions for loans made on the security of a home occupied or to be occupied by the borrower.[20] By contrast, NCUA rules on alternative mortgage lending did not specifically address late fees, although a federal credit union was permitted by statute to levy late charges in accordance with its by-laws for failure of a member to meet promptly its obligations.[21] OCC's ARM rule also did not specifically address late charges.

The federal regulators continue to have divergent policies regarding prepayment penalties and late charges under AMTPA. For example, OCC has promulgated a prepayment provision that applies only to ARM lending. This rule permits national banks to impose prepayment fees in connection with ARM loans notwithstanding contrary state laws. OCC applies this rule to state chartered commercial banks under AMTPA.[22] NCUA's statute, on the other hand, continues to bar federal credit unions from imposing prepayment fees on any loan. 12 U.S.C. 1757(5)(A)(viii). NCUA identifies its regulation implementing this ban and its regulation preempting state laws on prepayment limits for state chartered credit unions under AMTPA.[23]

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[20] 12 CFR 545.8-3(d) and (e) (1983).

[21] 12 CFR 701.21-6 and 701.21-6B, 12 U.S.C. 1757(10) (1982).

[22] 12 CFR 34.23 and 34.24.

[23] 12 CFR 701.21(a) and (b).

OTS notes that absolute competitive equality is simply not attainable through any unilateral OTS action in this rulemaking. While commenters argued that this rule would have a detrimental impact on the ability of state housing creditors to compete, state housing creditors have had, and will continue to have, a competitive advantage over federal depository institutions in other areas. Unlike national banks, federal credit unions, and federal savings associations, state housing creditors are not required to follow federal regulations for any particular transaction. If a state housing creditor makes an alternative mortgage transaction in a state that has a more favorable regulatory environment, it may elect to ignore the federal regulations and comply with appropriate state laws. Federally chartered institutions have only one choice of law.

OTS also notes that the 1996 rulemaking may have introduced other new inequalities into the alternative mortgage market by giving state housing creditors within OTS's jurisdiction a competitive advantage over depository institution competitors. For example, these state housing creditors may have gained an edge over state credit unions using AMTPA and federal credit unions, which are precluded from imposing prepayment fees. Moreover, while the 1996 rule permitted these state housing creditors to impose prepayment penalties to the same extent as national banks and federal savings associations, these depository institutions may have been disadvantaged since they remained subject to various federal restrictions on their ability to compete freely in the alternative mortgage

market.[24] These same restrictions do not apply to non-depository institution state housing creditors.

Thus, given the statutory scheme underlying AMTPA, complete competitive parity is impossible. Within this imperfect system, however, OTS has attempted to appropriately identify those regulations necessary for making alternative mortgages.

Commenters also speculated that the final rule would have a significant negative impact on the availability of affordable credit to borrowers. In AMTPA, Congress found that "alternative mortgage transactions are essential to the provision of an adequate supply of credit secured by residential property necessary to meet the [expected] demand * * * " 12 U.S.C. 3801(a)(2). This goal has been accomplished through AMTPA and other innovations in the mortgage market. In 1982, the mortgage industry relied on fixed-rate, fixed-term mortgage instruments that lenders, primarily depository institutions, funded through relatively short-term deposits. AMTPA addressed one side of this equation by increasing the availability of alternative mortgage transactions from state housing creditors.[25]

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[24] These restrictions include restrictions on loans to one borrower, real estate lending standards governing such matters as loans-to-value ratios and underwriting standards, and appraisal requirements.

[25] The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) also facilitated new mortgage products by extending the variable rate ceiling for national banks to all federally insured banks and thrifts (12 U.S.C. 85, 1463(g), 1785(g), 1831d(a)), and by providing for the preemption of state usury ceilings on "interest, discount points, finance charges and other charges" for loans secured by first mortgages on borrowers' homes. 12 U.S.C. 1735f-7a. *See* Kathleen C. Engel & Patricia A. McCoy, A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 Tex. L. Rev. 1255, 1275 (May 2002).

the other side of the equation – the liquidity of the mortgage market "has been enhanced through the government sponsored entities that fostered the creation of government-guaranteed mortgage-backed securities and through the emergence of private mortgage-backed securitization channels. Widespread securitization began in the 1980's and lenders now routinely originate loans for sale in the secondary market. The constant flow of money into the home mortgage market has dramatically altered the business of mortgage lending, significantly reducing liquidity issues for banks, thrifts, and other lenders. Securitization has also created opportunities for non-depository institutions. Lenders no longer need to be financial institutions with significant deposits and capitalization. Instead, thinly capitalized creditors can originate loans for sale on the secondary market.[26] As a result of these innovations, mortgage credit of all types is widely available and should not be significantly affected by this final rule.

Commenters also claimed that the proposed rule conflicts with the decisions in *National Home Equity Mortgage Ass'n v. Face*, 239 F.3d 633 (4th Cir. 2001); and *Shinn v. Encore Mortgage Services Inc.*, 96 F.Supp.2d 419 (D.N.J. 2000). Commenters noted that *Face* and *Shinn* held that state housing creditors within OTS jurisdiction may charge prepayment fees under § 560.34, notwithstanding any restrictions in state law.

OTS's analysis is consistent with these two decisions. In the *Face* case, the United States Court of Appeals for the Fourth Circuit held that non-federally chartered

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[26] *Id.* at 1273-74.

housing creditors could elect to have alternative mortgage transactions governed by OTS regulations on prepayment fees because OTS had identified its prepayment fee regulation as applicable to alternative mortgage transactions. The court explained as follows:

> The particular issue presented in this case is whether a non-federally chartered institution in Virginia may require and enforce a prepayment fee in a mortgage agreement notwithstanding Virginia's limitation on prepayment penalties as contained in Virginia Code §§ 6.1-330.83 and 6.1-330.85. *The resolution of this issue depends on whether the OTS has issued regulations authorizing prepayment fees as part of its regulations for alternative mortgage transactions*, because if it has authorized the collection of prepayment fees in alternative mortgage transactions, then Virginia may not apply its law proscribing such prepayment fees if the non-federally chartered housing creditor has otherwise complied with the requirements of the Parity Act.

239 F.3d at 638 (emphasis added). In short, the Court's ruling correctly rested on whether OTS had designated its prepayment fee regulation as applicable to alternative mortgage transactions. Under this analysis, if OTS did not so designate the prepayment fee regulation, then that regulation would not apply to alternative mortgage transactions, and non-federally chartered housing lenders would be subjected to state laws concerning prepayment fees.

Shinn addressed the limited issue of whether OTS acted reasonably and within the scope of its authority when it identified the prepayment provisions for alternative mortgage transactions under AMTPA. The *Shinn* case

held that OTS rules reflected "a permissible interpretation of the congressional authority vested in OTS" under AMTPA.[27] The *Shinn* ruling does not preclude a different interpretation by the agency under AMTPA.

Accordingly, the removal of the prepayment and late charge rules from its list of identified regulations for state housing creditors is consistent with OTS's authority under AMTPA.

B. Impact on Predatory Lending

Commenters opposing the rule asserted that OTS initiated the proposed rule to respond to allegations that state housing creditors use the AMTPA regulations to avoid state consumer protection laws governing prepayments and late charges and to engage in abusive lending practices. These commenters argued that the proposed rule would do little to address predatory lending. They noted that no single loan term or practice is the hallmark of a predatory loan and that prepayment penalties and late fees are not inherently predatory. These commenters observed that non-predatory loans often provide for prepayment penalties or late fees and that, under certain circumstances, these terms can make it more difficult for lenders to engage in certain types of predatory lending, such as loan flipping.

Other commenters, however, indicate that two key indicia of predatory lending are prepayment penalties and late charges.[28] Prepayment penalties may inhibit the

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[27] 96 F. Supp. 2d at 425.

[28] A national representative of community reinvestment groups provided this information based on data obtained from its consumer

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borrower's ability to refinance his or her loan at a lower rate. Prepayment penalties in sub-prime loans also function as deferred fees. Commenters indicated that over one-half of all sub-prime loans with prepayment penalties are eventually paid off with a penalty. These penalties typically are 5-7 percent of the loan amount.

Lenders may also impose excessive charges for untimely payments. Some alternative mortgage transactions regularly call for late fees of up to 10 percent of the monthly payment. Many states limit late fees to 4-5 percent of the payment amount.

Commenters opposing the proposed rule also argued that OTS cited no hard evidence indicating that prepayment penalties or late fees are subject to abuse under AMTPA regulations. Indeed, one commenter, a trade association representing a substantial segment of the real estate financing community, including national and regional lenders, mortgage brokers, mortgage conduits, and service providers, reported that it is unaware of any comprehensive report demonstrating that AMTPA rules are used to defraud or abuse customers. These commenters asserted that the anecdotal information provided in support of the ANPR is inadequate and that OTS should not proceed with this rule until it gains a more thorough understanding.

Because OTS does not directly regulate state housing creditors, it cannot collect information on state housing creditors that take advantage of AMTPA. OTS has found no comprehensive data available addressing this issue.

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rescue fund. The fund provides prime rate refinance loans for victims of predatory lending.

However, as discussed below, the data sources cited and additional data submitted by commenters suggest that unregulated prepayment penalties and late charges may be subject to abuse.

1. A joint report issued by the Department of Housing and Urban Development (HUD) and the Department of the Treasury found that prepayment penalties in high cost loans can inhibit borrowers from refinancing at lower rates when their credit improves.[29]

2. Prepayment penalties are becoming more common in sub-prime loans. One commenter estimated that the frequency of prepayment penalties in sub-prime loans was 10 percent in 1995. Yet the HUD/Treasury Report indicates that four years later approximately 70 to 76 percent of sub-prime mortgage originations carried prepayment penalties.[30] Several commenters cited data from nationally recognized statistical rating agencies confirming the HUD/Treasury Report estimate. By contrast, between 1 and 2 percent of prime borrowers currently are subject to such penalties.[31]

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[29] The Joint HUD/Treasury Report on Recommendations to Curb Predatory Home Mortgage Lending (Apr. 20, 2000) (HUD/Treasury Report) at 94.

[30] *Id.* at 93.

[31] *Id.* As noted elsewhere in this document, some commenters argued that creditors often offer lower rates in return for prepayment penalties. Other commenters disputed the notion that sub-prime borrowers freely accept prepayment penalties as a means to lower their interest rates. These commenters noted that the vast majority of sub-prime applicants are never offered one rate without a prepayment penalty and a lower rate with a penalty. Even if these offers were made, commenters alleged that interest rates on sub-prime loans are not standardized and it is extremely difficult to comparison shop.

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3. Various commenters provided data to demonstrate the extent to which prepayment penalties and late charges are used in predatory lending. Although OTS has not independently verified the accuracy of this information, commenters included the following data. One commenter, a national representative of community reinvestment groups, sampled 30 loans drawn from its rescue fund files. The commenter found that the vast majority of the loans were high cost loans with burdensome monthly payments that consumed unreasonable portions of borrower income and included prepayment penalties. The commenter observed that a significant portion of the loans also had high late fees of 10 percent of the overdue payment. To expand their sample, the commenter reviewed two prospectus statements for loan securitizations by major sub-prime lenders available on the SEC's Web site and concluded that over 80 percent of the loans in the pools had prepayment penalties. In addition, the commenter suggested that high delinquency rates showed a failure to adequately document borrower income levels and pricing inefficiencies. Numerous commenters offered anecdotal information of predatory lending in their communities, including practices directed at minorities and the elderly. For example, one fair housing center indicated that it had 417 predatory lending cases in 2001 and that all of the loans in these cases included a prepayment penalty for a period of at least five years. Ninety-seven percent of these cases involved ARMs.

Commenters further argued that it is implausible that sub-prime borrowers choose prepayment penalties such a high percentage of the time and prime borrowers do so only 2 percent of the time, particularly if one is describing a market that is driven by price competition.

The above information leads to the reasonable conclusion that sub-prime lenders often include prepayment penalties in sub-prime loans. OTS recognizes that there is some disagreement as to the extent that prepayment penalties may affect a borrower's ability or willingness to refinance. It is reported that one unidentified study found that sub-prime loans with prepayment penalties are prepaid at about 90 percent of the rate of sub-prime loans without prepayment penalties.[32] Nevertheless, common sense dictates that the existence of a prepayment penalty may well inhibit a borrower from refinancing his or her loan, which can be problematic where a good payment history may allow the borrower to graduate to a lower cost loan.[33] Equally important, prepayment penalties may also be problematic in the sub-prime market where a borrower may be forced to refinance on less favorable terms in order to avoid default.[34] Indeed, those circumstances may account for the prepayment of many sub-prime loans. Additionally, the cost of the prepayment penalty may be refinanced in the new loan balance, which drives up the overall price of the loan to the borrower. High penalties that are repeatedly financed into the cost of successive loans may be used by lenders to strip borrowers' equity in the home.[35]

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[32] HUD/Treasury Report *supra* note 29, at 94.

[33] *Id.*

[34] Engel & McCoy, *supra* note 25, at 1285.

[35] HUD/Treasury Report *supra* note 29, at 73-75, 94. The practice of repeated refinancing of a mortgage loan within a short time period with little or no benefit to the borrower is referred to as loan flipping. Loan flipping typically occurs when a borrower is unable to meet scheduled payments or repeatedly consolidates other unsecured debts into a new home-secured loan at the urging of a lender. In addition to

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In short, OTS can properly conclude that the widespread use of prepayment penalties not only may deter consumers from seeking to refinance high cost loans that have burdensome provisions, but also may have other adverse consequences for sub-prime borrowers, such as increasing the overall lending cost for a consumer who refinances to avoid default.

OTS believes that laws on prepayment penalties and late charges are a key component in states' regulation of predatory lending. Because these laws reflect each state legislature's judgment, after due consideration, about appropriate consumer protections applicable to state chartered lenders, OTS will not construe its authority under AMTPA to frustrate these state efforts where another less intrusive construction of AMTPA is permissible.

C. Scope of Preemption Under AMTPA

One commenter requested OTS to specifically state that creditors offering mortgages under AMTPA must comply with *all* state laws relating to alternative mortgages, except those that expressly conflict with regulations identified by OTS.

AMTPA provides little explicit guidance regarding the types of state laws that Congress intended to preempt. A few conclusions, however, may be drawn. AMTPA preempts state laws that would ban a state housing creditor from entering into an alternative mortgage (*e.g.*, a law

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the origination fees, each refinancing may trigger prepayment fees. Such fees may be refinanced as a part of the total loan amount and ultimately strip borrowers' equity out of the borrower's home. *Id.*

that bars variable rate loans). Similarly, state laws that conflict, or are inconsistent, with identified OTS regulations would be preempted. Because OTS is no longer identifying its regulations on prepayment penalties and late charges, state laws addressing prepayments or late charges generally would not be preempted by AMTPA.[36]

D. Alternatives, Modifications, and Clarifications

Commenters addressed the following alternatives, modifications, and clarifications of the proposed rule.

1. Modify Regulations Applicable to Federal Thrifts

As an alternative to the proposed rule, a number of commenters urged OTS to revise §§ 560.33 and 560.34. Commenters urged OTS to impose reasonable limitations on prepayment penalties and late charges by federal thrifts and apply these limitations to state housing creditors under AMTPA. Commenters suggested: (1) Banning prepayment penalties and late charges on all mortgage transactions or on high-cost alternative mortgage transactions; (2) Permitting prepayment penalties only during the

[36] The OTS April 30, 1996 legal opinion stated that AMTPA would preempt a state law even in the absence of a designated OTS regulation, if state housing creditors would be disadvantaged. Based on these statements, the commenter asserted that state laws addressing prepayment penalties would continue to be preempted even if OTS no longer designated §§ 560.33 and 560.34 as applicable. As noted above, OTS reviewed its prior position and, after further consideration, concluded that prepayment penalties and late charges are not essential to parity; that state housing creditors would not be disadvantaged within the meaning of AMTPA if state laws on these subjects applied to their loans; and that state laws on these subjects are not preempted.

first two years after origination of the alternative mortgage transaction; (3) Restricting the amount of prepayment penalties; and (4) Requiring a lender that wishes to impose a prepayment penalty to demonstrate that it has offered the customer a loan with a prepayment penalty and an identical loan (at a lower rate) without a prepayment penalty.

OTS declines to adopt any of these alternatives. OTS oversight and review of federal savings associations have not revealed a level of abusive practices that would warrant industry-wide regulation. Rather, OTS believes that the current prepayment and late charge regulations, when combined with the OTS comprehensive regime of regular examination and supervision of the lending activities of federal savings associations and its related enforcement activities, are adequate to address the operations of federal thrifts and to discourage their participation in predatory practices. In light of these factors, OTS is disinclined to impose new regulatory burdens on the federal savings associations within its jurisdiction.

Additionally, OTS notes that the suggested changes, to the extent they would regulate the operations of federal savings associations, fall beyond the scope of the proposed rule and would require additional public comment under the Administrative Procedure Act. 5 U.S.C. 553.

2. Apply §§ 560.33 and 560.34 to State Savings Associations

AMTPA requires OTS to identify regulations for state housing creditors, which includes both depository institutions and non-depository institutions. By contrast, OCC

and NCUA regulations apply only to depository institutions (*i.e.*, state chartered commercial banks and credit unions). The NPRM noted that state savings associations are subject to a safety and soundness regulatory scheme that is similar to the regulation of federal thrifts and substantially different from other state housing creditors. On this basis, OTS asked whether it should treat state chartered savings associations differently under AMTPA. OTS also asked whether AMTPA authorizes the agency to differentiate between state housing creditors on this basis.

The NPRM also noted that §§ 560.33 and 560.34 could be viewed as safety and soundness-based regulations. For example, § 560.34 permits federal thrifts to moderate prepayment risk through the assessment of prepayment penalties. Similarly, § 560.33 allows federal savings associations to encourage the timely payment of loans and to recover costs associated with late payment. Accordingly, OTS asked whether it was appropriate to apply these rules to some or all mortgage transactions by state chartered housing lenders that are depository institutions.

Commenters supporting this alternative observed that federal laws governing state and federal savings associations have become more similar since 1989 and that OTS has increasingly applied many federal thrift operational and supervisory regulations to state savings associations. Commenters also remarked that state and federal savings associations pursue similar strategies within a similar corporate and regulatory structure. As a result, the lending authority of these two types of depository institutions should be similar. Commenters also asserted that state savings associations were less likely to engage in predatory practices than unregulated lenders and mortgage brokers.

OTS is authorized under the HOLA to provide for the examination, safe and sound operation, and regulation of federal and state savings associations, and to issue appropriate regulations addressing these subjects. 12 U.S.C. 1462a(b)(2), 1463(a) and 1464(a).[37] However, state savings associations are also creatures of state law. States have responsibility for addressing safety and soundness, as well as legislating consumer protection for their citizens. OTS rules must strike a reasonable regulatory balance to permit the dual banking system to operate. Many state laws permit state chartered institutions to comply with laws and regulations governing federally chartered institutions as an alternative to state regulation. OTS believes that this choice should remain within state discretion and that state thrifts should be required to comply with state law, except where federal regulation is necessary.[38]

At this point, OTS has concluded that AMTPA does not permit it to distinguish between state chartered savings associations and other state housing creditors. AMTPA states that transactions by all state housing creditors, other than banks and credit unions, must be made in accordance with regulations governing alternative

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[37] While OTS has authority to apply these two regulations to state chartered savings associations, it has no authority under the HOLA over state savings banks. Therefore, OTS's application of these rules to state chartered savings associations would still result in disparate treatment for one type of depository institution, state chartered savings banks.

[38] Most states addressing the area have restricted the imposition of prepayment penalties, rather than imposed outright prohibitions against all such penalties for alternative mortgages. OTS is not aware of any state that prohibits all late charges. This illustrates that each state has weighed and struck its own balance regarding the regulation of state housing creditors and the protection of state consumers.

mortgage transactions issued by OTS. 12 U.S.C. 3803(a). While the statute indicates that state housing creditors include savings and loan associations, mutual savings banks, and savings banks, nothing in AMTPA or its legislative history permits OTS to identify different regulations for state housing creditors that are depository institutions. Accordingly, OTS has concluded that AMTPA does not permit the proposed distinction.

OTS, however, will continue to review the impact of these changes on state chartered savings associations and will consider suggestions from interested persons as to whether additional changes are permissible and necessary. If appropriate, OTS may address this matter in a separate rulemaking at some future date.

3. Definition of Alternative Mortgage Transaction

AMTPA defines an alternative mortgage transaction as a loan or credit sale secured by an interest in residential real property –

> (A) in which the interest rate or finance charge may be adjusted or renegotiated;
>
> (B) involving a fixed-rate, but which implicitly permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule; or
>
> (C) involving any similar type of rate, method of determining return, term, repayment, or other variation not common to traditional fixed-rate, fixed-term transactions, including without limitation, transactions that involve the sharing of equity or appreciation;

> described and defined by applicable regulation * * * [39]

Thus, AMTPA applies to all manner of mortgage instruments that do not conform to the traditional fully-amortized, fixed-interest rate mortgage loan. OTS rules adopt this statutory definition without elaboration.[40]

Several commenters requested OTS to clarify whether loans with certain terms are alternative mortgage transactions under OTS rules. Specifically, commenters seek clarification regarding the following loan terms:

- Interest rates that reduce if the borrower pays on time. OTS has opined that loans that permit rate adjustments to reflect a borrowers' actual payment performance can be alternative mortgage transactions under paragraph (A) or (C) of the definition.[41]

- Balloon payments. To the extent that a loan has a fixed rate, but permits rate adjustments by having the debt mature at the end of an interval shorter than the term of the amortization schedule (*e.g.*, a balloon loan), a loan may

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[39] 12 U.S.C. 3802(1).

[40] The current regulation at 12 CFR 560.220 includes a specific cross-reference to the statutory definition, but the proposed rule text did not. To clarify this point, OTS has revised the final rule to include the statutory reference.

[41] *See* OTS Op. Chief Counsel (Nov. 27, 1996) (A loan that explicitly provides for a specified increase in the interest rate if the borrower becomes delinquent for more than 30 days twice in a revolving twelve month period is an alternative mortgage transaction under paragraph (A) or (C) of the definition).

be an alternative mortgage transaction under paragraph (B).[42]

- Shared appreciation. Shared appreciation loans are specifically included in the definition at paragraph (C) and can be an alternative mortgage transaction.

- Prepayment penalties and late charges. While prepayment penalties and late fees may affect a creditor's rate of return on a loan, conventional prepayment penalties and late charges are "common to traditional fixed-rate, fixed-term transactions" and do not transform a fixed-rate, fixed-term loan into an alternative mortgage transaction.

- Negative amortization. Some mortgages, such as ARMs and graduated payment loans, are designed to negatively amortize or have the potential to negatively amortize, in the absence of delinquency or default. OTS believes that these transactions are alternative mortgages under AMTPA.

Several commenters asked whether loans with interest rates that adjust insignificantly or within a very narrow range would fall within the definition of an alternative mortgage transaction. The AMTPA definition does not expressly require a loan to adjust by a minimum amount before it may be considered to be an alternative mortgage transaction. However, creditors issuing loans

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[42] *See* OTS Op. Chief Counsel (Feb. 10, 1997). *But see Hays v. Bankers Trust Co.*, 46 F. Supp. 2d 490, 499 (S.D.W.V. 1999) (footnote 17 states that AMTPA applies only to ARMs and does not cover the loan at issue, which was a balloon loan. This footnote appears to be erroneous in light of paragraph (B) of the definition).

that are alternative in form, but not substance, solely to obtain the benefits of preemption, assume the risk that the loans may not be found to be alternative mortgage transactions within the AMTPA definition.

4. Definition of State Housing Creditor

One commenter cautioned that certain statements in the NPRM were misleading to the extent they indicated that a housing creditor must hold a state license to be eligible to make a loan under AMTPA. The commenter observed that state laws exempt certain creditors from state licensing obligations. AMTPA does not unconditionally require a housing creditor to hold a state license.[43] Rather, it merely requires a creditor to hold a state license where the underlying state law imposes a licensing requirement.

5. Preemption for Operating Subsidiaries

Two commenters asked OTS to confirm that operating subsidiaries of federal thrifts have the same lending authority and benefits of federal preemption as federal thrifts and, thus, do not need to use AMTPA to preempt state law. Another commenter, however, hinted that operating subsidiaries of federal thrifts should be treated like other state housing creditors under AMTPA.

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[43] 12 U.S.C. 3802(2) states: "A person is not a 'housing creditor' with respect to a specific alternative mortgage transaction if, except for this chapter, in order to enter into that transaction, the person would be required to comply with licensing requirements imposed under State law, unless that person is licensed under applicable State law and such person remains, or becomes, subject to the applicable regulatory requirements and enforcement mechanisms provided by State law."

Under OTS rules, operating subsidiaries of federal thrifts are subject to the same requirements as federal thrifts. For example, an operating subsidiary is permitted to engage in any activity that the federal savings association may conduct directly. 12 CFR 559.3(e)(1). Unless specifically provided by statute, regulation, or OTS policy, all federal statutes and regulations apply to operating subsidiaries in the same manner as they apply to federal savings associations. 12 CFR 559.3(h)(1). In addition, state laws apply to operating subsidiaries only to the extent that they apply to a federal savings association. 12 CFR 559.3(n)(1). OTS has taken these positions because operating subsidiaries, which may only engage in activities permissible for its parent federal savings association and must be controlled by the thrift, are treated as the equivalent of the parent thrift for regulatory and reporting purposes.[44] Because operating subsidiaries of federal savings associations have the same lending authority and benefits of federal preemption, they do not need to use AMTPA to preempt state law.

6. Retroactive Application

One commenter asked whether the final rule will apply to loans consummated before the effective date. The commenter warned that borrowers would argue that the new rule must apply retroactively to existing transactions because OTS was "incorrect" when it revised the rules in 1996. In this final rule, OTS has selected between two permissible interpretations of AMTPA based upon a reevaluation of the statute. OTS has, in no way, concluded

[44] *See* 61 FR 66561, 66563 (Dec. 18, 1996).

that the 1996 rule changes reflected an impermissible construction of its statute. Accordingly, there is no basis for arguing that the final rule applies retroactively to transactions consummated before the effective date.

Even if OTS were to assume that it had the ability to apply this rule retroactively, such a position would seriously disrupt the mortgage markets. Borrowers and originating lenders have made pricing decisions regarding the interest rates and conditions and terms of mortgages based on the inclusion or exclusion of prepayment penalties. Similar pricing decisions have been made regarding secondary sales of these mortgages, either on a whole loan basis or as a part of mortgage pools backing securities. OTS does not believe that it may take away or impair vested rights acquired under a lawfully issued and effective regulation.

E. Legislative Recommendations

Numerous commenters on the NPRM urged OTS to recommend that Congress repeal AMTPA. These commenters noted that AMTPA was passed in a high interest rate environment and was designed to permit state chartered institutions to offer alternative mortgage transactions that were otherwise prohibited under state law. Because all states, except one, permit alternative mortgage transactions, these commenters asserted that AMTPA has outlived its usefulness and may be repealed. Other commenters, however, supported the retention of AMTPA. These commenters noted that state laws continue to restrict or prohibit alternative mortgage transactions and that local governments are beginning to regulate this area.

Legislative actions affecting AMTPA are beyond the scope of this rulemaking. In OTS's view, however, piecemeal legislative and regulatory solutions aimed at the various complex issues raised under AMTPA – predatory lending, the availability of credit, and parity among housing creditors – are not the best way to approach this problematic area. Accordingly, OTS and a substantial number of commenters on the NPRM believe that that [sic] Congress should revisit AMTPA, in the context of broader mortgage reform legislation involving the Real Estate Settlement Procedures Act,[45] the Truth In Lending Act,[46] and predatory lending. Only comprehensive reform can guarantee that borrowers receive meaningful information in a comprehensive and comprehensible form, that healthy competition between housing creditors is stimulated so that affordable housing credit continues to be available to consumers, and that statutory and regulatory burdens are minimized. OTS continues to advocate broad-based reform in this area as well as a review of existing laws that have inconsistencies and duplications that make the mortgage process more complicated and expensive for consumers than is needed.

OTS also indicated that it would make two recommendations if Congress decides to retain AMTPA. First, OTS suggested that Congress should give states a new opportunity to opt out from AMTPA preemption. Congress originally gave the states three years to opt out of AMTPA preemption. If a state opted out, state housing creditors would continue to be bound by the state's regulations on

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[45] 12 U.S.C. 2601 *et seq.*

[46] 15 U.S.C. 1601 *et seq.*

alternative mortgage transactions.[47] Only a handful of states decided to reject preemption.

Commenters opposing a new opt out period argued that this change would increase costs to consumers, raise new compliance issues, reduce certainty in the markets, and raise the possibility that Congress would add new opt out period to other statutes including DIDMCA. One commenter feared that many states would opt out, which would gut the application of what was intended as a uniform law.

The mortgage loan market has seen dramatic and fundamental changes since the original opt out period closed in 1985. Certain changes, such as the general acceptance of alternative mortgage transactions under state law and the increased availability of housing credit, may have been anticipated. The states, however, could not have anticipated other changes, such as the explosion in sub-prime lending, increases in predatory practices by lenders, and the breadth of preemption of state law permitted under AMTPA. Given these changes, OTS believes that the states should have a new opportunity to opt out of AMTPA.

OTS also indicated that it would recommend that Congress require state housing creditors making loans under AMTPA to identify themselves to the states. Several commenters observed that this disclosure would enhance enforcement and monitoring activities by state supervisory agencies, fair housing organizations, and others. One

[47] 12 U.S.C. 3804(a).

commenter, however, argued that this revision is unnecessary because AMTPA requires state housing creditors to comply with state licensing requirements and states have the authority to require these creditors to identify themselves to the state regulator.

OTS continues to believe that enforcement is difficult unless states have a reliable means of identifying AMTPA creditors. OTS will continue to make this recommendation to ensure that all states have the ability to utilize their applicable enforcement mechanisms.

II. Preemption of State Usury Laws (12 CFR Part 590) – Late Fees on Federally-Related Residential Manufactured Housing Loans

Part 590 implements section 501 of DIDMCA.[48] Section 501 provides for the permanent preemption of state laws that expressly limit the rate or amount of interest, discount points, finance charges, or other charges assessed in connection with certain federally-related residential loans. This preemption does not apply to loans secured by a first lien on a residential manufactured home unless the loan complies with consumer protections in § 590.4. This regulation addresses such matters as balloon payments, prepayment penalties, late charges, deferral fees, notice before repossession or foreclosure, and the refund of prepaid interest. Section 590.4(f) specifically addresses late charges. Paragraph (f)(4) states: "To the extent that applicable state law does not provide for a lower charge * * * a late charge on any installment * * *

[48] 12 U.S.C. 1735f-7a.

may not exceed the lesser of $5.00 or five percent of the unpaid amount of the installment."

OTS proposed to eliminate the $5.00 limit. Two commenters opposed this change. They noted that this change would permit lenders to increase allowable late fees several times over the current levels and would facilitate predatory lending. Commenters also observed that low-income borrowers, including limited-income seniors, are more likely to live in manufactured homes and would be adversely affected by the rule change. Four commenters supported the proposed change because it would: (1) Ensure that lenders are adequately compensated; (2) provide a stronger self-adjusting incentive for consumers to pay on time; and (3) provide parity with late charges permitted under state laws.

OTS has not adjusted the $5 limit on late fees in 20 years. As a result, the limit has not kept pace with lenders' costs and is too small to serve as an effective deterrent to late payment. According to commenters, the $5 limit is an effective percentage rate of only 1.3 percent of the average manufactured home loan payment. This amount is well below the prevailing state late fee for manufactured housing, which commenters assert is 5 percent of the loan installment payment. By contrast, the proposed limit is within the mix of late fee structures established under state law.

While some commenters feared that the proposed rule would facilitate predatory lending, the revised regulation continues to impose effective limitations on such practices. As revised, § 590.4 limits the late charge to 5 percent of the unpaid amount of the installment unless the state

provides for a lower amount. In addition, the rule would continue to provide that:

- No late charge may be assessed, imposed, or collected unless the written contract between the borrower and the lender provides for the charge (§ 590.4(f)(1)).

- No late charge may be collected if an installment is paid in full on or before the 15th day after its scheduled or deferred due date, unless state law permits a longer period (§ 590.4(f)(2)).

- A late charge may be imposed only once on an installment, and may not be collected if an installment has been deferred § 590.4(f)(3).

The NPRM asked whether OTS should also eliminate the 5 percent limit on the amount of the late fee and permit state law to govern the amount of late charges. One commenter supported and one commenter opposed this change. A third noted that this alternative would not have a significant impact since few states allow late charges in excess of 5 percent.

OTS has retained the 5 percent late fee limitation. While few states permit a lower charge, OTS believes that the 5 percent fee serves as an effective consumer safeguard to the extent that states permit late fees in excess of 5 percent of the unpaid amount.

III. Preemption of State Due-on-Sale Laws (12 CFR Part 591) – Definition of Reverse Mortgage

OTS proposed a minor technical change to part 591, which implements section 341 of the Garn St. Germain

Depository Institutions Act of 1982 (12 U.S.C. 1701j-3).[49] Part 591 governs due-on-sale clauses in real estate loans and the preemption of state prohibitions on such clauses. OTS proposed to revise the definition of reverse mortgage at § 591.2(n) to clarify that a reverse mortgage is not limited to a loan that provides for periodic payments, but also includes a loan that provides for a lump sum payment. This change is consistent with OTS legal opinions,[50] and no commenter addressed the issue. The proposed rule is adopted without change.

IV. Regulatory Certifications

A. Executive Order 12866

The Director of OTS has determined that the final rule does not constitute a "significant regulatory action" for purposes of Executive Order 12866.

B. Unfunded Mandates Reform Act of 1995

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act), requires an agency to prepare a budgetary impact statement before promulgating a rule that includes a federal mandate that may result in expenditure by state, local, and tribal governments, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider

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[49] Pub. L. 97-320, 96 Stat. 1469 (1982).

[50] OTS Op. Chief Counsel (June 2, 2000) (reverse mortgage loans include an instrument providing for a lump sum payment).

a reasonable number of regulatory alternatives before promulgating a rule. OTS has determined that the rule will not result in expenditures by state, local, or tribal governments or by the private sector of $100 million or more. Accordingly, a budgetary impact statement is not required under section 202 of the Unfunded Mandates Act of 1995.

C. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601-612) requires federal agencies to prepare a final regulatory flexibility analysis with a final rule that was subject to notice and comment, unless the agency certifies that the rule will not have a significant impact on a substantial number of small entities.

Parts 590 and 591. OTS did not prepare an initial or final regulatory flexibility analysis for the revisions to parts 590 and 591. The change to part 590 affects creditors making federally-related loans secured by first liens on residential manufactured housing. The final rule provides these creditors with greater flexibility in charging late fees, while retaining the benefits of preemption of state usury laws under section 501 of DIDMCA. The current rule limits late fees to $5, which has proven to be too small to deter late payments. The final rule permits the imposition of a more tangible penalty and will benefit all creditors making such loans, including small businesses. Part 591 permits all lenders, whether federally- or state chartered, to exercise due-on-sale clauses in real property loans without regard to state law. The final rule makes a clarifying change that broadens the definition of reverse mortgage and codifies an existing OTS interpretation.

OTS believes that the impact of the final rule on lenders should be beneficial. Thus, OTS certifies to the Chief Counsel of Advocacy of the Small Business Administration that the changes to parts 590 and 591 will not have a significant economic impact on a substantial number of small entities.

Section 560.220. OTS has performed a final regulatory flexibility act analysis for the changes to § 560.220. A description of the reasons why OTS is adopting the final rule, a statement of the objectives of, and legal basis for, this aspect of the final rule are included in the supplementary material above. In addition, OTS has addressed the following topics.

1. Small Entities to Which the Rule Applies

Section 560.220 applies to state housing creditors other than credit unions or commercial banks. OTS does not compile data on the total number of state housing creditors that may utilize § 560.220. Moreover, except for state chartered savings associations, OTS does not have any authority to require state housing creditors to identify themselves or submit other data to OTS. Similarly, AMTPA does not require state housing creditors to notify the states that they are taking advantage of it. As a result, OTS has little information regarding how many state housing creditors may use § 560.220 or how many of these creditors are small businesses.

Nonetheless, OTS estimates that 6,757 small state housing creditors may be affected by this regulation. United States Census data indicates that 7,257 firms (excluding depository institutions) engage in real estate credit. OTS estimates approximately 6,457 of these firms

are small businesses.[51] Based on the most recent TFR and Call Report data, OTS estimates that an additional 300 state chartered savings associations and state savings banks are small businesses.[52] For purposes of this analysis, we have assumed that all 6,757 of these small businesses engage in alternative mortgage transactions.

OTS believes that this number may overstate the number of small businesses that may be affected by the changes to the final rule for several reasons. First, the use

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[51] OTS based this figure on firms reported under NAICS 522292 and the special tabulation of the 1997 economic census from the United States Bureau of the Census. The initial regulatory flexibility analysis estimated that 6,300 of the 7,257 firms were small businesses. OTS has revised this figure to reflect recent increases to SBA's thresholds defining small businesses. A firm engaged in real estate credit is now considered small if it has total receipts of $6 million or less per year. 67 FR 3041 (Jan. 23, 2002) *to be codified* at 13 CFR 121.201. The threshold previously was $5 million. 13 CFR 121.201 (2002). While the 1997 special tabulation does not indicate the number of real estate credit firms that had less than $6 million in receipts, it indicates that an additional 157 firms had less than $7.5 million in receipts. Recognizing that this number will overstate the number of small businesses satisfying the $6 million threshold, OTS has estimated that there are 6,457 small firms engaged in real estate credit.

[52] OTS originally estimated that an additional 86 depository institutions were small state chartered housing creditors. This number has been revised to 300. The number used in the initial regulatory flexibility analysis did not include state savings banks, and must be recalculated to reflect recent changes to the SBA's thresholds defining small depository institutions. Until recently, small depository institutions were defined, for RFA purposes, as depository institutions with assets under $100 million. 13 CFR 121.201 (2002). The threshold amount, however, was increased to $150 million. *See* 67 FR 3041 (Jan. 23, 2002) *to be codified* at 13 CFR 121.201. Based on March 2002 TFR data, OTS regulates 135 state savings associations. Of these savings associations, 93 have assets of $150 million or less. Based on March 2002 Call Report data, the FDIC regulates 508 state savings banks. Of these state savings banks, 207 have assets of $150 million or less.

of AMTPA is solely at the election of the state housing creditor. State housing creditors may, for whatever reason, decline to use AMTPA for their alternative mortgage transactions. Moreover, many small state housing creditors will conduct alternative mortgage transactions that are governed by laws in states that either:

- Opted out of AMTPA. State housing creditors conducting alternative mortgage transactions governed by these laws currently cannot use § 560.220 to preempt state law; or

- Enacted statutes that do not impose any substantive prohibitions and restrictions on prepayments or late charges for the loans. State housing creditors may continue to charge penalties and fees on alternative mortgage transactions in these states, notwithstanding the final rule.

OTS's original estimate of small businesses was based on the best information available to it. OTS encouraged commenters with access to more complete and more accurate data to submit information regarding the number of state housing creditors (other than credit unions or commercial banks) that may be affected by this rule. OTS also requested information regarding how many of these creditors may be small businesses.

One commenter argued that OTS underestimated the number of small businesses affected by the rule. The commenter asserted that OTS excluded 40,000 to 50,000 mortgage brokers who originate the majority of residential loans in the United States. The commenter also asserted that thousands of appraisers and title companies would also see diminished revenues.

OTS used United States Census data to determine the number of non-depository institutions that would be effected by the rule. Specifically, OTS used the Census classification – NAICS 522292 – Real Estate Credit, which is a subcategory within NAICS 5222 – Non-Depository Credit Intermediation. NAICS 5222 includes establishments that are primarily engaged in extending credit or lending funds raised by credit market borrowing. Within this group, industries are broken out based on the type of credit extended. The selected classification – NAICS 522292 – comprises non-depository institutions that are engaged in lending funds with real estate as collateral and includes mortgage bankers and loan correspondents.

The Regulatory Flexibility Act requires an agency to consider direct effects that a regulation may have on small businesses that it regulates. OTS is not, however, required to analyze the effects of its rule on entities that it does not regulate. Arguably, OTS regulates state housing creditors that make loans, credit sales, or advances secured by interests in real property.[53] However, it does not directly

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[53] OTS questions whether a regulatory flexibility analysis is required for the rule. Revised 12 CFR 560.220 imposes no restriction or limitation on any small entity's ability to impose prepayment penalties or late charges. Rather, the rule leaves the regulation of these matters entirely to the discretion of the individual states. As a result, OTS believes that it may certify that the rule will not have a significant impact on a substantial number of small entities. *See American Trucking Ass'n, Inc. v. EPA*, 175 F.3d 1027 (D.C. Cir. 1999) (The D.C. Circuit held that EPA was not required to perform a regulatory flexibility analysis for its national ambient air quality standards (NAAQS). The NAAQS imposed no regulations on small entities. Instead, each state regulated small entities through the state implementation plans that they were required to develop under the Clean Air Act. Because the NAAQS regulated small entities only indirectly – that is, insofar as they affected the planning decisions of the states – the

(Continued on following page)

impose any regulation on those entities that garner fees through brokerage services or through other services that facilitate the credit intermediation process. Accordingly, OTS has not included within its tabulation entities that appear within the classification NAICS 5223 – Activities Related to Credit Intermediation. This classification includes establishments that are primarily engaged in facilitating credit intermediation by performing activities, such as arranging loans by bringing borrowers and lenders together on a commission or fee basis.[54]

2. Requirements of the Rule

AMTPA permits certain state housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation, provided that they comply with regulations identified by OTS. As described more fully in the supplementary information section, the final rule no longer identifies rules on prepayment and late charges for state housing creditors under AMTPA. As a result, these state housing creditors will likely be subject to state laws addressing prepayment and restricting late charges.

OTS is unable to quantify the impact of the final rule on small state housing creditors for several reasons. Based on available data, it is difficult to determine how many alternative mortgage transactions were made under OTS AMTPA regulations. Industry-wide data is available only

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EPA concluded, and the D.C. Circuit agreed, that small entities were not subject to the rule).

[54] Mortgage and non-mortgage loan brokers are included within a subcategory of this classification – NAICS 52231.

for one type of alternative mortgage transaction – ARMs. Other types of mortgages with alternative features are generally reported as fixed-rate mortgages. The available data, however, indicates that all housing lenders originated $243.6 billion and $256 billion in ARMs in 2001 and 2000, respectively.[55] The most recent data available indicates that state housing creditors (excluding commercial banks and thrifts) account for approximately 56.3 percent of all lending or $137.1 billion and $144.1 billion of ARMs in 2001 and 2000.[56] OTS estimates that $17.0 billion and $17.9 billion of these ARM loans were originated by small state housing creditors in 2001 and 2000.[57] This available data, however, does not distinguish between transactions that are made under AMTPA, and those that are not. As noted above, OTS has no authority to require state housing creditors that use § 560.220 to provide this information.[58]

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[55] The Mortgage Bankers Association's Web site at www.mbaa.org indicates that the industry originated $2,030 billion in 1- to 4-family mortgages in 2001, and $1,024 billion of these loans in 2000, and that 12 percent and 25 percent of these loans were ARMs in 2001 and 2000, respectively.

[56] This information was also obtained on the Mortgage Bankers Association's Web site, which indicates that its source was a HUD Survey of Mortgage Lending Activity discontinued in 1998.

[57] OTS computed this figure using receipts by real estate creditors as proxy for originations. Based on these figures, OTS estimates that small creditors accounted for 12.4 percent of all ARM originations by real estate creditors.

[58] OTS does not currently collect data on the ARM originations by the small state savings associations. However, March 2002 CMR data indicates that these 93 thrifts hold approximately $1.04 billion of ARMs in their portfolios. Again, this data does not distinguish transactions subject to AMTPA regulations.

In the ANPR and NPRM, OTS attempted to obtain more complete and accurate information regarding the extent to which state housing creditors and small state housing creditors engage in alternative mortgage transactions under AMTPA. OTS also requested information concerning the amount of late fees and prepayment penalties generated by these alternative mortgage transactions. Commenters, however, provided no reliable additional information on this subject.[59]

Even if reliable estimates were available, these amounts would not accurately reflect the impact of the deletion of the preemption of prepayment charge provisions and late charge provisions. The 6,757 small state housing creditors that may be affected by the final rule will become subject to a broad range of state laws. For example, some of these laws may continue to permit the imposition of prepayment penalties. Others may prohibit or restrict prepayment charges. Still other laws would subject prepayment penalties to a range of restrictions, such as prohibiting penalties for a set period after execution of the note or mortgage or limiting the amount of the prepayment penalty. Based on this wide variety of restrictions and the fact that state laws will change over time,

[59] One of the commenters on the ANPR, a trade association representing a substantial segment of the real estate financing community, including national and regional lenders, mortgage brokers, mortgage conduits, and service providers, stated that it "does not have specific numbers regarding the extent to which lenders are using AMTPA to craft alternative mortgage products that would otherwise be affected by state law. Furthermore [it] knows of no reliable and comprehensive industry data from any source."

OTS cannot determine how much income would be lost by small state housing creditors under the rule.[60]

Moreover, the impact of the loss of prepayment penalties may be ameliorated somewhat through other techniques. For example, lenders often impose a higher overall interest rate where prepayment penalties are excluded from the loan agreement.[61] In addition, some commentators assert that the payment of points upon origination and the imposition of a prepayment penalty are economically equivalent transactions. Since a mortgage with points includes an implicit and easily calculable prepayment penalty, state housing creditors may substitute points where prepayment penalties are prohibited.[62]

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[60] *See* "The Handbook of Mortgage-Backed Securities," 88-101 (Frank J. Fabozzi, ed. (5th ed. 2001)), which contains a compilation of current state laws on prepayment penalties.

[61] In April 2000, one large sub-prime lender indicated that it lowered the interest rate on a loan by 75 basis points for those borrowers who accepted a prepayment penalty. *See* Joint HUD/Treasury Report supra note 29, at 93, citing information from the New Century Mortgage Corporation Web site, www.newcentury.com.

[62] Alan L. Feld & Stephan G. Marks, Legal Differences Without Economic Distinctions: Points, Penalties, and the Market for Mortgages, 77 B.U. L. Rev. 405 (1997). Some commenters objected to OTS's suggestion that state housing creditors can "ameliorate loss of income by substituting points or simply raising rates." They argued that a point is an immediate, out-of-pocket cost to a borrower. That cost is fixed regardless of whether the borrower keeps the loan for its full term, or chooses to repay or refinance the loan at some earlier date. By contrast, a prepayment penalty does not necessarily cost the borrower anything if the loan is retained through the prepayment penalty period. Commenters asserted that state housing creditors would be at a distinct disadvantage because they must charge higher rates and points. Even if one assumes that the average loan will prepay and cost a penalty, such costs in the aggregate will be less than if lenders are

(Continued on following page)

Some commenters indicated that OTS did not fully consider all impacts on small businesses, such as increased compliance costs to conform to newly applicable states [sic] laws, and the negative economic effects on small entities' ability to offer a competitive product, to address prepayment risk, or to access the secondary loan markets. Commenters, however, did not provide any reliable estimates or sources of information regarding the magnitude of these impacts on small entities.

3. Significant Alternatives

Section 603(c) of the RFA requires OTS to describe any significant alternatives that accomplish the stated objectives of the rule while minimizing any significant economic impact of the rule on small entities. Section 603(c) lists several examples of significant alternatives, including: (1) Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) clarifying, consolidating, or simplifying compliance and reporting requirements for small entities; (3) using performance standards rather than design standards; and (4) excepting small entities from coverage of the rule or a part of the rule.

OTS considered retaining its current identification of regulations for all state housing creditors. For the reasons discussed above, OTS believes that this course is inappropriate. OTS also considered whether it should continue to identify the existing regulations for small state housing

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forced to ameliorate. Even if competitive equality were not the issue, state housing creditors would still be limited by state caps on rates.

creditors, but not for other state housing creditors. However, given its analysis of the purposes and goals of AMTPA, OTS has concluded that it is inappropriate to distinguish between small and large state housing creditors.

OTS solicited comments on other alternatives that would minimize the burdens on small state housing creditors. The commenters did not suggest any alternatives aimed at small housing creditors. Other alternatives, however, are discussed in the supplementary information section above.

4. Other Matters

Various federal rules or statutes duplicate or overlap with the final rule. NCUA has identified all of its lending regulations as applicable to alternative mortgage transactions by state chartered credit unions. 12 CFR 701.21(a). These regulations address such matters as the term of the loan, requirements governing security instruments, notes, liens, due-on-sale provisions, and assumptions. These rules specifically prohibit prepayment penalties and preempt state laws on prepayment limits and late charges. OCC, on the other hand, has identified as applicable to state chartered commercial banks, its rules that directly relate to ARMs. OCC's identified regulations define ARM loans; state that ARMs may be made, sold, purchased, participated in, or dealt in without regard to any state law limitation on those activities; authorize certain indexes; and allow prepayment fees. 12 CFR 34.24.

In addition, the Home Ownership and Equity Protection Act (HOEPA)[63] imposes limits on certain high cost mortgage loans by state housing creditors. These limits include restrictions on balloon payments, prepayment penalties, and other matters. Other federal statutes and rules may also preempt the application of state laws on prepayments and late fees for alternative mortgage transactions by state housing creditors. *See e.g.*, 12 CFR 590.4 (preemption of state usury laws under section 501 of DIDMCA – first liens on residential mobile homes) and 12 CFR part 591 (preemption of state due-on-sale clauses under section 341 of Garn St. Germain Depository Institutions Act of 1982).[64]

OTS is aware of no federal rules or statutes that conflict with the final rule.

D. Federalism

Executive Order 13132 imposes certain requirements on an agency when formulating and implementing policies that have federalism implications or taking actions that preempt state law. In accordance with those requirements, OTS has consulted with the Conference of State Bank

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[63] Pub. L. No. 103-325 (1994), 108 Stat. 2160, amending the Truth in Lending Act, 15 U.S.C. 1601 *et seq*. The reference to HOEPA was not included in the initial regulatory flexibility analysis.

[64] One commenter argued that the initial regulatory flexibility analysis incorrectly listed part 590 as an overlapping or duplicative provision because 12 U.S.C. 3805 states that the consumer protections in section 501(c)(1) of DIDMCA do not apply to alternative mortgage transactions under AMTPA. State housing creditors, however, may rely on state law rather than AMTPA for authority to make alternative mortgage transactions. If they do, they may assert preemption under section 501 under DIDMCA.

Supervisors and the National Association of Attorneys General concerning this change.

List of Subjects

12 CFR Part 560

Consumer protection, Investments, Manufactured homes, Mortgages, Reporting and recordkeeping requirements, Savings associations, Securities.

12 CFR Part 590

Banks, banking, Loan programs – housing and community development, Manufactured homes, Mortgages, Savings associations.

12 CFR Part 591

Banks, banking, Loan programs – housing and community development, Mortgages, Savings associations.

Accordingly, the Office of Thrift Supervision amends 12 CFR parts 560, 590, and 591 as set forth below:

PART 560 – LENDING AND INVESTMENT

1. The authority citation for part 560 continues to read as follows:

Authority: 12 U.S.C. 1462, 1462a, 1463, 1464, 1467a, 1701j-3, 1828, 3803, 3806; 42 U.S.C. 4106.

2. Revise § 560.220 to read as follows:

§ 560.220 Alternative Mortgage Transaction Parity Act.

(a) *Applicable housing creditors.* A housing creditor that is not a commercial bank, a credit union, or a federal savings association, may make an alternative mortgage transaction as defined at 12 U.S.C. 3802(1), by following the regulations identified in paragraph (b) of this section, notwithstanding any state constitution, law, or regulation. *See* 12 U.S.C. 3803.

(b) *Applicable regulations.* OTS identifies §§ 560.35 and 560.210 as appropriate and applicable for state housing creditors. All other OTS regulations are not identified, and are inappropriate and inapplicable for state housing creditors. State housing creditors engaged in credit sales should read the term "loan" as "credit sale" wherever applicable in applying these regulations.

PART 590 – PREEMPTION OF STATE USURY LAWS

3. The authority citation for part 590 continues to read as follows:

Authority: 12 U.S.C. 1735f-7a.

4. Revise the section heading and paragraph (f)(4) in § 590.4 to read as follows:

§ 590.4 Federally-related residential manufactured housing loans – consumer protection provisions.

* * * *

(f) * * *

(4) To the extent that applicable state law does not provide for a lower charge or a longer grace period, a late charge on any installment not paid in full on or before the 15th day after its scheduled or deferred due date may not exceed five percent of the unpaid amount of the installment.

* * * *

PART 591 – PREEMPTION OF STATE DUE-ON-SALE LAWS

5. The authority citation for part 591 is revised to read as follows:

Authority: 12 U.S.C. 1464 and 1701j-3.

6. Revise § 591.2(n) to read as follows:

§ 591.2 Definitions.

* * * *

(n) *Reverse mortgage* means an instrument that provides for one or more payments to a homeowner based on accumulated equity. The lender may make payment directly, through the purchase of an annuity through an insurance company, or in any other manner. The loan may be due either on a specific date or when a specified event occurs, such as the sale of the property or the death of the borrower.

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Dated: September 20, 2002.

By the Office of Thrift Supervision.

James E. Gilleran,
Director.

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67 Fed. Reg. 76,304 (Dec. 12, 2002)

DEPARTMENT OF THE TREASURY

Office of Thrift Supervision

12 CFR Parts 560, 590 and 591

[No. 2002-59]

RIN 1550-AB51

Alternative Mortgage Transaction Parity Act; Preemption Delay of Effective Date

AGENCY: Office of Thrift Supervision, Treasury.

ACTION: Final rule; delay of effective date.

SUMMARY: The Alternative Mortgage Transaction Parity Act (AMTPA) authorizes state chartered housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation. To rely on AMTPA, certain state chartered housing creditors must comply with regulations issued by the Office of Thrift Supervision (OTS). OTS recently revised its rule identifying the OTS regulations that apply under AMTPA. This document delays the effective date of that revised rule.

EFFECTIVE DATE: This amendment modifies the effective date of the final rule published September 26, 2002 at 67 FR 60542. The effective date of the revision to 12 CFR 560.220 is delayed until July 1, 2003. The effective date of amendments to 12 CFR 590.4 and 591.2 remains January 1, 2003.

FOR FURTHER INFORMATION CONTACT: Theresa Stark, Senior Project Manager, Compliance Policy, (202)

906-7054; Karen Osterloh, Special Counsel, (202) 906-6639, Regulations and Legislation Division, Office of Thrift Supervision, 1700 G Street NW., Washington, DC 20552.

SUPPLEMENTARY INFORMATION:

I. Background

AMTPA authorizes state chartered housing creditors to make, purchase, and enforce alternative mortgage transactions without regard to any state constitution, law, or regulation. To rely on AMTPA, however, certain state chartered housing creditors must comply with designated OTS regulations on alternative mortgage transactions. On September 26, 2002, OTS published a final rule revising 12 CFR 560.220, which identifies the OTS regulations that apply to state housing creditors making alternative mortgage transactions under AMTPA.[1] Under the final rule, OTS will no longer identify its regulations on prepayments and late charges as applicable to state housing creditors. As a result, alternative mortgage transactions made by state chartered housing creditors under AMTPA will become subject to state and local laws on these subjects. The rule was to become effective on January 1, 2003.

In late November and early December 2002, several representatives of financial service trade associations (petitioners) filed written requests for extensions of the January 1, 2003 effective date. The petitioners argued that the three-month delayed effective date did not provide a

[1] 67 FR 60542 (Sept. 2002).

sufficient time for the industry to address implementation issues.

II. Discussion

A. Implementation Issues

Upon reconsideration, OTS believes that an extension is warranted to provide state housing creditors with additional time to adapt to newly applicable state and local requirements.[2] Specifically, OTS believes that a delay is necessary to permit state housing creditors to: (1) Determine applicable legal requirements; (2) reprogram systems and rewrite documents; and (3) conduct training.

Under the revised OTS rule, state housing creditors that engage in alternative mortgage transactions under AMTPA will become subject to state laws on prepayment penalties and late charges. During the last six years, state housing creditors have been able to rely on AMTPA to avoid these state limitations. As a result, many will have little recent experience with applicable state laws on prepayment penalties and late charges. Because state prepayment penalty and late charge restrictions for alternative mortgage transactions frequently differ substantially from restrictions on fixed-rate products, any experience that a state housing creditor may have with applicable restrictions on fixed-rate mortgages may be irrelevant.

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[2] The September 26, 2002 final rule also made unrelated revisions to 12 CFR part 590 (Preemption of State Usury Laws) and 12 CFR part 591 (Preemption of State Due-on-Sale Laws). OTS is not revising the effective date of these other rule changes. Therefore, the changes to parts 590 and 591 will be effective on January 1, 2003.

Thus, as a result of the final rule, state housing creditors will be required to conduct an in-depth review of applicable state laws to ensure that their alternative mortgage transactions will not violate these laws – a significant endeavor for state housing creditors that operate nationwide or in multiple jurisdictions.

In addition to ascertaining the scope of applicable restrictions on prepayment penalties and late charges, state housing creditors will be required to undertake the following significant modifications to systems and documents to ensure compliance with state law: (1) Rewrite promissory notes and loan agreements; (2) prepare and program newly required disclosures, including disclosures to be delivered at or prior to origination and disclosures required during loan servicing; (3) modify loan origination systems to accurately reflect legal requirements and applicable codes; (4) modify servicing systems; and (5) develop audit and quality control programs.

Finally, state housing creditors will have to retrain their employees and agents on the new legal requirements for their various loan products and on the use of the updated systems and documents. Such activities may require the production of appropriate training materials and conducting training sessions for employees.

B. New Effective Date

In determining the effective date for new regulations that impose additional requirements on insured depository institutions, OTS must consider, consistent with the principles of safety and soundness and the public interest, any administrative burdens that the regulation would

place on depository institutions and customers of depository institutions, and the benefits of the regulation.[3]

Based on the administrative burdens described by petitioners. OTS believes that the original January 1, 2003 effective date was inadequate to permit state housing creditors, including insured depository institutions, to perform all of the tasks necessary to respond to the new regulatory environment in a coherent manner.[4] OTS is reluctant to place state housing creditors in a position where they are unable to comply or are forced to put unready or untested systems into operation. Such an action could result in borrowers receiving loans that do not meet the requirements under state law. This may harm consumers to the extent that they are charged prepayment penalties that are prohibited under state law, or are precluded from electing a lower rate in return for a prepayment penalty where such penalties are permitted. In addition, such an action could result in lawsuits, which could undermine consumer confidence in the mortgage industry. Accordingly, OTS will extend the effective date of the AMTPA rule.

Almost three months have passed since the issuance of the September 26, 2002 final rule. By now, OTS anticipates that most state housing creditors have researched and analyzed the applicable law and are beginning to update their operating systems and documents and take other steps toward compliance with the revised regulatory

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[3] 12 U.S.C. 4802.

[4] While commenters on the proposed rule addressed various compliance burdens, the effective date of the rule was not identified as a significant issue in the comments or discussed at any length.

environment. OTS believes that a delay of an additional six months, as requested by several petitioners, will be sufficient for state housing creditors, including companies with regional or national operations, to complete good faith efforts to implement the remaining changes required by the revised rule. OTS notes that this extended date is more than nine months after the publication of the final rule on September 26, 2002.

OTS also considered whether to extend the effective date to January 1, 2004, as requested by some petitioners. However, OTS believes that this effective date raises other issues, including new implementation issues. As one commenter observed, changes required by the end of a calendar year are particularly problematic because so many functions must be performed at the year-end that sufficient staff is often not available to make the changes, test the changes, and train other employees. OTS believes that this factor weighs against an effective date of January 1, 2004. Moreover, a January 1, 2004 effective date will unreasonably delay, and thus deny, consumers the protections accorded under state law with regard to prepayment penalties and late charges on loans made by state housing creditors. In the final rule, OTS examined the AMTPA rule's impact on predatory lending and concluded that the widespread use of prepayment penalties may deter consumers from seeking to refinance high cost loans with burdensome provisions and may have other adverse consequences for sub-prime borrowers. OTS further concluded that state laws on prepayment penalties and late charges are a key component in states' regulation of predatory lending, and that its current AMTPA rules may frustrate these state efforts. OTS is disinclined to thwart

these efforts to combat predatory lending by unnecessarily extending the implementation period.

In light of these factors, OTS will extend the effective date of the revised AMTPA rule for six additional months until July 1, 2003.[5]

III. Regulatory Analyses

To the extent that this extension of the effective date is deemed to be a rule under the Administrative Procedure Act (APA), OTS makes the following regulatory findings.

A. Administrative Procedure Act

Under the APA, an agency may suspend general notice-and-comment rulemaking procedures if the agency "for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. 553(b)(3)(B). OTS finds that it has good cause to delay the effective date without first soliciting comment concerning this action. Because the effective date of the final rule (January 1, 2003) is fast approaching, it is

[5] Thus, loans consummated on or after July 1, 2003 will be governed by revised § 560.220. However, if a loan is made pursuant to a legally binding loan commitment made before July 1, 2003, the loan will be governed by the prior OTS rule. Where a prospective borrower pays no fee for a commitment, state housing creditors should closely review the loan commitment to determine if a legally binding commitment exists. These agreements typically contain broad provisions permitting the lenders to decline to fund the loan on subjective grounds that effectively render the commitment unenforceable and therefore not legally binding.

impracticable to seek further public comment before issuing this amendment delaying the effective date of those rules. In addition, such a delay is in the public interest for the reasons explained above. For similar reasons, OTS also finds that this action delaying the effective date of the final rule must take effect on January 1, 2003, which is less than 30 days after publication of this amendment to the final rules.

B. Regulatory Flexibility Act

Under section 604 of the Regulatory Flexibility Act (RFA) (5 U.S.C. 604), a final regulatory flexibility analysis is required only for notice-and-comment rulemakings conducted under section 553 of the APA. Since OTS has found that there is "good cause" under the APA for not proceeding with notice-and-comment rulemaking for this amendment to the effective date for the final rules, the RFA does not require that a final regulatory flexibility analysis be provided for this amendment. Moreover, OTS provided a regulatory flexibility analysis in the preamble to the final rule published on September 26, 2002 (67 FR 60551-60554). In that regulatory flexibility analysis, OTS considered the likely impact of the final rule on small entities.

C. Executive Order 12866

The OTS determination that the final rule does not constitute a "significant regulatory action" (67 FR 60551) applies to the rule, as amended by this effective date revision.

D. Unfunded Mandates Act of 1995

The Unfunded Mandates Reform Act of 1995 (UMA) applies only when an agency is required to issue a general notice of proposed rulemaking or a final rule for which a general notice of proposed rulemaking was published. 2 U.S.C. 1532. As noted above, OTS has determined, for good cause, that this amendment to the final rule may be issued without prior notice and comment. Accordingly, OTS has concluded that the UMA does not require an unfunded mandates analysis of this amendment to the final rules. Moreover, OTS provided an UMA analysis in connection with the final rule. 67 FR 60551.

E. Executive Order 13132 – Federalism

As described in the preamble to the final rule (67 FR 60554), Executive Order 13132 imposes certain requirements on an agency when it formulates and implements policies that have federalism implementations. In accordance with those requirements, OTS consulted with the Conference of Bank Supervisors and the National Association of Attorneys General concerning this amendment to delay the effective date of the rule.

Dated: December 6, 2002.

By the Office of Thrift Supervision.

James E. Gilleran,

Director.

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